IN THE

Supreme Court of the United States

October Term, 1977

Nos. 77-753 and 77-754

INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA; LOCAL 705, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, AND LOUIS PEICK,

Petitioners,

vs.

JOHN DANIEL,

Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF RESPONDENT JOHN DANIEL.

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OPINIONS BELOW.

The opinion of the district court (Pet. App. pp. 106-134) is reported at 410 F. Supp. 541. The opinion of the Court of Appeals for the Seventh Circuit (Pet. App. pp. 209a-262a) is reported at 561 F. 2d 1223.[1]

1. Petitioners Local 705 International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America, and Louis F. Peick will hereinafter be referred to as "Local 705" and their brief as "Local 705 Br." Petitioner International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America will hereinafter be referred as as "IBT" and its brief as "IBT Br." The joint appendix filed by Petitioners in this Court will hereinafter be referred

(Footnote continued on next page.)

STATEMENT OF THE QUESTION PRESENTED.

We do not accept petitioners' statement of the question presented on this appeal and thus restate the question we believe is lodged here for review: Whether plaintiff's interest in the Local 705 Pension Trust Fund constitutes a "security" acquired by way of a "sale", as those terms are defined in the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"), for the sole purpose of applying the antifraud provisions of the federal securities laws?

STATEMENT OF THE CASE.

A. Plaintiff's Claim.

The plaintiff, John Daniel has brought this lawsuit to seek relief for certain fraudulent and illegal activities undertaken by defendants in connection with the sale of interests in the Local 705 International Brotherhood of Teamsters Pension Trust Fund (the "Local 705 Pension Fund"). The defendants include the IBT, Local 705, the Local 705 Pension Fund, and the officers of Local 705 and trustees of the Local 705 Pension Fund. The only claims in issue on this interlocutory appeal involve Counts I and II of the Complaint relating to violations of the antifraud provisions of the federal securities laws.

Counts I and II seek relief for defendants' fraudulent and intentional misrepresentations and omissions of material fact relating to the sale to plaintiff of interests in the Local 705 Pension Fund, all in violation of Section 17(a) of the Securities Act of 1933, 15 U. S. C. § 77a-77aa, and Section 10(b), and Rule 10b-5 thereunder, of the Securities Exchange Act of 1934, 15 U. S. C. § 78a-78jj, and 17 C. F. R. § 240.10(b)-5. Such misrepresentations and omissions include among others:

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to as "Pet. App." Other references to "Br." preceded by a name will similarly refer to a brief filed in the court below or in this Court by that party or amicus.

(i) misleading statements as to the length and continuity requirements for the payment of a pension benefit from the Local 705 Pension Fund to plaintiff;

(ii) omitting to state the requirements for a payment of a pension benefit from the Local 705 Pension Fund to plaintiff;

(iii) omitting to state that all investments made by the plaintiff in the Local 705 Pension Fund, and all accumulated earnings thereon, will be forfeited if the length and continuity requirements are not met;

(iv) omitting to state that the likelihood the Local 705 Pension Fund will ever pay a pension benefit to plaintiff is substantially less than half;

(v) omitting to state the success or failure of the Local 705 Pension Fund in managing the monies in the Fund and the investments of the Fund; and

(vi) omitting to state that funds held in trust by the Local 705 Pension Fund have been diverted from their lawful purposes.

B. The Plaintiff.[2]

The plaintiff, John Daniel, invested in the Local 705 Pension Fund over the period from 1955 through November, 1973, and his investment is now *worthless*. Local 705 established the multi-employer Local 705 Pension Fund as of January 1, 1955.[3] Pursuant to the terms of the labor contracts negotiated by Local 705, part of the consideration received by Daniel and all other Local 705 members for labor services provided to Local 705 covered employers has been invested into the Local 705 Pension Fund.[4] These investments were made, pursuant to such con-

2. See generally the affidavit of Respondent, John Daniel, which is reproduced in Respondent's Br. In Opposition to the Petitions for Writs of Certiorari, pp. App. 1-App. 7 (hereinafter referred to as "Daniel Aff.").

3. The Local 705 Pension Trust Fund was created by a Trust Agreement between Local 705 and certain employer groups, pursuant to Section 302(c)(5) of the National Labor Relations Act ("NLRA"), 29 U. S. C. § 186(c)(5). Local 705 Br. at 6.

4. The investments by Local 705 union members into the Local 705 Pension Fund are substantial. Thus, a member of Local 705

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tracts, directly into[5] the Local 705 Pension Fund on behalf of such Local 705 union members by their employers as part consideration for labor services provided. The monies so invested into the Local 705 Pension Fund have been held in trust and invested and managed by Local 705 Pension Fund trustees for the benefit of all such Local 705 members who have invested in the Fund.

Daniel worked for Local 705 covered employers for a period of 22½ *consecutive years* and was denied a pension from the Local 705 Pension Fund. He first became a member of Local 705 in April, 1950, and at the same time entered into employ-

(Footnote continued from preceding page.)

now invests $30.00 per week, or $1,560 per year, through employer contributions into the Local 705 Pension Fund. A. S. Hansen, Inc., Affidavit, Local 705 Br. at p. A10. The aggregate value of all such monies invested by a Local 705 member over his trucking career are likely to be very large. Indeed, this investment is probably the largest investment a union member will ever make in his lifetime, "exceeding in value the owner-occupied single-family home, as well as the automobile." Drucker, *The Unseen Revolution,* p. 43 (1976). The aggregate value of all monies invested by Local 705 members in the Local 705 Pension Fund since its inception totals some $153 million. A. S. Hansen, Inc., Affidavit, Local 705 Br. at p. A7. If these securities are being sold by means of a fraud, it is a problem crying out for a remedy.

5. The primary reason for the payment of such part of an employee's compensation package *direct* into the Local 705 Pension Fund by the employer, rather than first to the employee and subsequently by the employee into the Local 705 Pension Fund, is tax related. For plans qualified under Section 401 of the Internal Revenue Code of 1954, employers are (within certain limits) permitted to deduct contributions made to such plans on behalf of covered employees, and the covered employees may defer the payment of tax on such employer contributions made on their behalf until actually received on retirement. See generally, M. Bernstein, *The Future of Private Pensions,* (New York, The Free Press of Glencoe, 1964) at pp. 198-200. Because of this tax incentive, it has been estimated that 96 percent of all pension plans have qualified under Section 401. See S. Rep. No. 1150, 92nd Cong., 2d Sess. 110 (1972). Clearly, the fact that (because of tax reasons) this part of an employee's compensation is paid (as above described) by the employer on behalf of the employee direct into a pension plan does not detract from the conclusions that (1) value is given by the employee in exchange for his interest in the Local 705 Pension Fund, and (2) the employee is an investor in the Local 705 Pension Fund.

ment as a truck driver with an employer who had a labor contract with Local 705. Until his retirement at age 63 on account of poor vision, he only worked as a truck driver for employers who were under collective bargaining agreements with Local 705. Daniel has not worked at all since his retirement on December 1, 1973.[6]

Over the whole 22½ year period of his employment career with Local 705 covered employers, Daniel's *sole* absence was a forced four month absence due to an economic lay off from his job.[7] Although this brief absence was strictly involuntary, Local 705 has seized upon it to deny Daniel a pension for not complying with its 20 year *continuous* service vesting rule,[8] notwith-

6. Daniel Aff. Para. 2-3.

7. Daniel was laid off by his employer on December 5, 1960, and he returned to work in April, 1961. During this four month lay off period, he tried unsuccessfully to find alternative trucking employment. Daniel Aff. Para. 4. Subsequent to his return to work and for an approximate three month period, April to July 5, 1961, his employer's bookkeeper embezzled certain funds, including those monies which should have been invested on Daniel's behalf into the Local 705 Pension Fund. On learning what happened, Daniel reported the facts to Local 705 and was assured by Local 705 that "they would take care of whatever had to be done on account of the embezzlement." *Id.* Para. 5. Notwithstanding such promise, Local 705 has consistently treated Daniel's break-in-service as a seven- rather than a four-month interruption. Local 705 Br. at 10. *Indeed, on this interpretation, even if Daniel had not been involuntarily laid off for four months, he would have been denied a pension from the Local 705 Pension Fund because of the alleged break in service arising from the three month embezzlement.*

8. In order to receive a retirement benefit from the Local 705 Pension Fund over the period of time at issue in this lawsuit, a Local 705 union member must have met certain eligibility requirements established by the Board of Trustees of the Local 705 Pension Fund. One major hurdle which had to be cleared was the "length requirement": a union member had to have 20 years of service with an employer or employers who had a collective bargaining agreement with Local 705 for the payment of a normal retirement pension. Local 705 Pension Plan Section 2.01(b); Pet. App. 72a p. 8. A second major hurdle which had to be cleared by a union member seeking his pension was the continuity of service requirement: the 20 years of covered service which a union member had had to be *continuous and uninterrupted* with absolutely no break-in-service (prior to 1970), or with less than a two year break-in-service (under

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standing his admitted 22½ years of service.[9]

The establishment of the Local 705 Pension Fund was an important element in Daniel's decision to continue working with Local 705 covered employers.[10] Daniel understood the Local 705 Pension Fund to insure the financial security of his old age. He recognized that he would be investing in the Local 705 Pension Fund through contributions made on his behalf into the Fund by his covered employers as part of his compensation for labor services performed; and that these contributions (together with the profits earned thereon) would, in part, finance the pension benefits he counted on receiving after retirement.[11]

The economic inducements to Daniel to invest in the Local 705 Pension Fund were substantial.[12] In fact, the economic pay off promised from a Teamster pension fund has been a key selling point used both by employers to convince employees to enter into employment and by the various Teamster unions to convince employees to certify the Teamster union as their exclusive representative in labor negotiations.[13] Daniel and the other members of Local 705 have, as a result, consistently voted in favor of collective bargaining agreements which provide for employer contributions on their behalf into the Local 705

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certain conditions) subsequent to 1969. Local 705 Pension Plan Section 2.01(b) and 2.05; Pet. App. 72a pp. 8 and 11. Presumably, under the Trustee's interpretation of this continuity requirement, a Local 705 union member whose 20 years of covered service from 1955 to 1975 was interrupted by a 1 month, or even a 1 day break in service in 1965, would be denied a retirement benefit from the Local 705 Pension Fund. This Draconian result befell plaintiff here: John Daniel was denied a pension benefit, notwithstanding his total 22½ years of covered service, because of a 4 month involuntary break-in-service in 1960.

9. Daniel Aff. Para. 14-15.

10. *Id.* Para. 7.

11. *Id.* Para. 6.

12. *Id.* Para. 9-10.

13. For example, articles in the first eight issues of the 1976 edition of *International Teamsters* (the union's magazine) were devoted to the Teamster pension plans.

Pension Fund in lieu of additional direct cash wage increases.[14] The economic importance of employee pension plans to employee decision making is not, however, unusual. A Federal Mediation and Conciliation Service Study has, for example, concluded that pensions are second only to cash wages as a determinate of employee decisions. Simkin, Union Membership Rejection of Contract Settlements, *Labor Relations Yearbook*, pp. 334, 342 (1967).[15]

14. This Court has thus noted that: "[F]uture [pension] benefits may be traded off against current compensation." *Alabama Power Co.* v. *Davis,* 431 U. S. 581, 593 (1977). A recent study prepared for the Department of Labor by the University of Maryland concludes, for example, that workers who receive pension benefits "pay for them" by accepting correspondingly lower wages. U. S. Dept. of Comm., *The Value of Defined Benefit Pension Plans: A Test of the Equalizing Differences Hypothesis* (Nat'l Tech. Info. Service, 1978). And, a Senate pension study has indicated:

> "Since labor negotiations resulting in wage increases through collective bargaining invariably include some consideration of pension benefits, employees believe that had pensions not been included in the settlement package, they would have received higher wage commitments." S. Rep. No. 634, Interim Report of Activities of the Pension Welfare, Pension Plan Study, 92d Cong., 2d Sess. 75 (1972).

See further the Amer. Acad. of Actuaries Br. at 19:

> "The parties may bargain for an increase in wages and then decide how much should be in the form of increased wages and how much contributed for funding retirement benefits."

Cf. S. Slichter, J. Healy, E. Livernash, *The Impact of Collective Bargaining on Management* 373 (1960) (pension plans encouraged during World War II by difficulty of obtaining general wage increases); Note, Pensions: Security In The Future or Securities Under The Law, 27 *Cath. U. L. Rev.* 364, 368 (1978).

15. This conclusion has been confirmed by a recent University of Maryland Study prepared for the Department of Labor. U. S. Dept. of Comm., *Internal and External Labor Markets: An Analysis of Manpower Utilization* (Nat'l Tech. Info. Service, 1978).

Daniel learned of the Local 705 Pension Fund only through mailings from and other communications with the Fund itself, the trustees of the Fund, Local 705, and the officers of Local 705. However, these communications intentionally misrepresented and failed to disclose certain material facts pertaining to the value of an interest in the Local 705 Pension Fund. For example, such materials did not disclose the minimum length of time considered to constitute a break-in-service in the Local 705 Pension Fund 20 years continuous service vesting rule; such materials did not disclose that all contributions made on behalf of a Local 705 member into the Local 705 Pension Fund (and all accumulated profits on the aggregate of such contributions) would be forfeited following any proscribed break in service; such materials did not disclose that service credit in one Teamster pension fund would not count toward service credit in most of the other 229 teamster pension funds; and such materials did not disclose the fact that very few Local 705 members would ever receive a pension benefit.[16]

The importance of such information is revealed by a recent statistical survey of employee pension plans which concludes that *fewer* than 10 percent of all participants in those plans which require 11 or more years of service for vesting will ever receive any pension benefits.[17] Interim Report on the Activities of the Private Welfare and Pension Plan Study, Senate Committee on Labor and Public Welfare, S. Rep. No. 634, 92d Cong., 2d Sess. 15, 115-153 (1972) (hereinafter referred to as *Senate Pension Study*). A more material fact relating to the

16. Daniel Aff. Para. 11 and 12.

17. If only 10 percent of the Local 705 members participating in the Local 705 Pension Fund ever receive any pension benefits, the question arises as to who benefits from the forfeitures resulting from the unlucky 90 percent. A clue to the answer of this question may be found in a recent study of the Teamster unions. PROD, *Teamster Democracy and Financial Responsibility*, pp. 81-89 (1976). However, any real effort to uncover the basic facts relating to the operation of Teamster pension funds has been thwarted by the chilling effect of Teamster violence. See A. A. Raskin, "Can Anybody Clean Up The Teamsters," *N. Y. Times Mag.*, Nov. 7, 1976.

value of an interest in an employee pension plan could not be imagined.[18]

18. The full Senate Committee on Labor and Public Welfare has thus concluded, on review of its Subcommittee's study, that this study

> "established that forfeiture of pension benefits by plan participants was extremely high in that 92 percent of all participants who left plans which required 11 or more years of service for vesting and 73 percent of all participants in the plans with 10 years or less for vesting did not qualify for benefits upon termination of employment." *Senate Pension Study* at 15.

Petitioners' efforts to discredit this study must fail. See IBT Br. at 86 n. 74. First, similar studies, reported in the legislative history of ERISA and cited by petitioners' own *amicus*, have reached the similar conclusion that far less than 50 percent of all participants in union negotiated pension plans would ever receive a retirement benefit. See ERISA Regulations Industry Committee (ERIC) Br. before the Seventh Circuit below, at p. 28 and n. 20:

> "Other estimates have progressed from 10 percent [Legislative History of the Employee Retirement Income Security Act of 1974, Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare, April, 1976 ("ERISA Leg. Hist."), Vol. I at 1218] . . ., to 22 percent (*Id.*, Volume I at 1267), to 28 percent (*Id.*, Volume I at 1089) to 33½ percent (*Id.*, Volume II at 1599)."

Second, because the *Senate Pension Study* is limited to plans with a vesting requirement of *11 years or more*, and because the Local 705 Pension Fund has a stringent *20 years* of continuous, uninterrupted service vesting requirement, the *Senate Pension Study* conclusion that only 8 percent will ever receive pension benefits is probably the best guideline to actual Local 705 Pension Fund experience. Indeed, the *Senate Pension Study* reports further that in 1969 only 3 percent of all pension plans with vesting requirements had a vesting schedule more onerous than that of the Local 705 Plan. *Senate Pension Study* at 19. It also reported that the probability of receiving a pension benefit is appalling *even for those participants with an extended service record:*

> "The study has also disclosed that substantial numbers of workers who did not qualify for any pension benefits *were long-service employees.* [In those plans with a vesting requirement of 11 years or more,] . . . for every two participants who received a normal, early, or deferred retirement benefit since 1950, one participant forfeited despite more than 15 years service; for every one participant who received a benefit, one participant with more than 10 years service forfeited, 3 participants with more than 5 years service forfeited, and 16 participants with 5 years service or less forfeited." *Id.* at 65 (Emphasis added.)

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Finally, such materials do not disclose the success or failure of the Local 705 Pension Fund trustees in managing the monies in the Fund and the type of investments in which such monies are placed.[19] This information is vital because the performance of the Fund affects the economic return to a participant on his investment. Higher performance will ultimately lead to larger retirement benefits, and poor performance underscores the risk of loss of a participant's investment. It has thus been estimated that for every 1 percent increase of investment earnings, pension benefits can be raised 20 percent. M. Bernstein, *The Future of Private Pensions* (New York, The Free Press of Glencoe, 1969) at 41. See also *Employee Benefit Plan Review* (No. 4) 50 (1954).[20] This relationship of investment performance to bene-

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Third, even Local 705 has now *conceded* that Daniel's chances of ever receiving a pension were no more than 50 percent at the time of his entry into employment with Local 705 covered employers. Local 705 Seventh Circuit Br. at p. 32. Of course, Plaintiff denies the accuracy of Local 705's estimate because it is *not* a likelihood based on actual experience, but a theoretical number based on actuarial assumptions, the accuracy and appropriateness of which have never been demonstrated and, indeed, are challenged in this lawsuit. However, in any event, whether the percentage of participants ever receiving a pension benefit is 8 percent or 33⅓ percent or even 50 percent is irrelevant because all such numbers are of the utmost materiality to an investor in the Local 705 Pension Fund.

19. Daniel Aff. Para. 12. The recently authorized Department of Justice criminal investigation into the management of various Teamster pension funds suggests that these monies have been unlawfully diverted from their proper purposes. See generally PROD, *Teamster Democracy and Financial Responsibility* (1976). Indeed, the investment profile of at least one Teamster pension fund, the Central States, Southeast and Southwest Area Pension Fund, reveals a shocking 89 percent commitment to real estate loans. See p. 60, *infra*. This is in sharp contrast to the average investment of all private noninsured pension funds of from 1 to 2 percent of their total funds in real estate loans. SEC, *Statistical Bulletin* at 5-7 (May, 1978).

20. The American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") has itself noted in its *amicus* brief: ". . . where the level of defined benefits is collectively bargained, employers generally will be more willing to promise higher benefits to the extent that the contributions required are less because of the plan's investment income." AFL-CIO Br. at 13 n. 16.

fit growth has, in fact, been stressed by Local 705 in one of its own informational booklets:

> "Another advantage [of the Local 705 Pension Fund] is that the contributions earn income by being invested. Consequently, the money originally contributed grows. Without this income growth the Fund could not accumulate enough money to pay the $250.00 monthly pensions provided by the Plan." Pet. App. 70a at p. 14.

Daniel and the other Local 705 members have invested in the Local 705 Pension Fund in reliance on such misleading communications. In addition, because Daniel had been employed every year for 23 consecutive years with Local 705 covered employers, he believed that upon retirement he would qualify for a Local 705 Pension Fund pension.[21] Having only completed elementary school,[22] Daniel also relied to a large extent on the " 'fraternal'—if not paternal—proclamations of Local 705 that the Local 705 Pension Fund will 'afford protection to you and your wife . . . [and will] take care of you and your family in case of retirement.' "[23] *Daniel* v. *International Brotherhood of Teamsters*, 410 F. Supp. at 545. However, Daniel's request for a pension was denied by the Local 705 Pension Fund trustees because of their interpretation of the 20 year service rule—that such service be continuous without any break or interruption. In his attempt to receive his pension, Daniel exhausted all intra-union and intra-Local 705 Pension Fund procedures by applying and appearing twice before the Fund trustees in his effort to overturn their denial of his pension application.[24]

21. Daniel Aff. Para. 13-14.

22. *Id.*, at Para. 2.

23. *Id.*, at Para. 9-10. The Local 705 Pension Fund communications provided Daniel have been aptly characterized by the District Court below as "obfuscated by many pages of small print and couched in ambiguous or technical language." *Daniel* v. *International Brotherhood of Teamsters*, 410 F. Supp. at 545.

24. Daniel Aff. Para. 14-15.

In brief, plaintiff John Daniel was induced to invest substantial value into the Local 705 Pension Fund by defendants' intentional misrepresentations of material facts and omissions to state other material facts relating to the value of plaintiff's investment. Daniel was induced to invest on the promise of substantial economic profits. While misrepresenting the profits to be made, the defendants also failed to set out, or even mention, the substantial risks of loss. As a result of defendants' securities fraud, Daniel's investment into the Local 705 Pension Fund is worthless.

C. The Plaintiff's Investment Vehicle.

The interest of the plaintiff in the Local 705 Pension Fund is analogous to an interest in a mutual fund acquired through a periodic investment plan. This has been recognized by the SEC for over 35 years:

> "In fact, many employee plans are in the nature of investment trusts and are indistinguishable in legal effect from investment companies offering securities to the public at large." Testimony of then SEC Commissioner Purcell in Hearings on Proposed Amendments to the 1933 and 1934 Acts before the House Comm. on Interstate and For. Commerce, 77th Cong., 1st Sess., at 895-96 (1941) (hereinafter referred to as the *1941 Hearings*).

Former SEC Chairman Manuel F. Cohen has stressed the same similarities:

> "In many respects, pension plans and mutual funds have features in common . . . First, both investor and employee are investing money which they have earned. *There is no gratuity involved. Realistically, the employee is simply putting into a fund for his future use that which he would otherwise get in his paycheck.* And the employer finds it to be in his interest to contribute to that fund and to do so under circumstances which will stimulate contributions by his employees. Both the investor and the employee—and the employer—place their confidence and trust in an administrator who is in a position to exercise expert judgment concerning the management of their funds . . . Both [mutual funds and employee pension plans] represent huge contributions of economic power in our society." Hearings on S. 3598 Before the Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare, 92d Cong., 2d Sess. at 231 (1972) (hereinafter referred to as the *1972 Hearings*) (emphasis added).

Plaintiff's interest in the Local 705 Pension Fund constitutes, moreover, his sole investment vehicle in the American capital markets. This is no longer unusual. Because of tax provisions and economies of scale, pension funds are the most efficient way for most workers to invest. N. Ture, *The Future of Private Pension Plans* 3 (1976). Private employee pension plans, such as the Local 705 Pension Fund, are today the primary investment vehicle for most working Americans:

> "In 1940, an estimated four million employees were covered by private pensions; in 1950, the figure had more than doubled to 9.8 million; in 1960, over 21 million employees were covered; and in 1973, approximately *30 million workers participated.* Currently, one-half of the industrial work force in the United States are members and participants of private pension plans. It is projected that by 1984, 42.3 million workers will be covered by private pension plans. The growth of the assets owned or controlled by pension funds has closely paralleled this expansive growth. Total estimated assets of pension plans have accelerated from $2.4 billion in 1940 to *$150 billion in 1973* and are increasing at a rate projected to exceed $250 billion by 1980." S. Rep. No. 127, 93rd Cong., 2d Sess. 2-3 (1973). (Emphasis added)[25]

Further, private non-insured pension funds are now the largest investors in the American capital markets. At the end of 1972, they held 11 percent in value of *all* New York Stock Exchange listed stocks, and in 1972 they accounted for over 23 percent of the dollar value of all shares traded on the New York Stock

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25. According to the latest figures in SEC, *Statistical Bulletin* 6-8 (May, 1978), as of December 31, 1977, the total asset book value of all private noninsured pension funds in the country amounted to $181.5 billion and the total asset book value of all private insured pension reserves (including separate accounts) amounted to another $98.1 billion.

Exchange. New York Stock Exchange, *1973 Fact Book* 51-52, 75 (1973).

One highly informed commentator has characterized this profound change as "The Unseen Revolution", noting that the investment by a fund participant in an employee pension plan is likely to be "the largest single asset for the middle aged American family." Drucker, *The Unseen Revolution* 43 (1976); see n. 4, *supra*. However, "Unseen" or seen, what 35 years ago was perhaps a novel way of investing is now widely spread. No reason appears, moreover, why working Americans should be excluded from the protection of the antifraud rules because of the *form* of their investment vehicle.[26] As the court of appeals has noted below (Pet. App. p. 241a-242a):

> "Because employee pension plans are now the major, if not sole, form of investment for most American workers to provide for their old age and because of the now crucial role that such plans play in today's capital markets, they are just the sort of investment vehicle that the securities acts were passed to regulate. To proclaim that the securities laws encompass securities consisting of interests in pension plans is 'quite consistent with the congressional enactment and with the role of the federal judiciary in interpreting it * * *.' *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737, . . . The type of fraud allegedly perpetrated on the plaintiff is among those the securities laws were passed to prevent and remedy."

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26. The general counsel for the SEC thus stated on oral argument below:

> "The real issue . . . before this Court, is whether there can ever be any set of facts which would give rise to a cause of action under the Anti-Fraud provisions of the Federal Securities Laws for fraud and misrepresentation in the inducement of entering into a pension fund plan. This is the sole issue . . . before this Court . . . whether [under] allegations of . . . lying, stealing and cheating, [the] anti-fraud provision[s] can ever be applicable to an interest in a pension fund. We assert that they can." Transcript pp. 33-35.

D. The Teamsters Fraud and Scienter.

The securities fraud complained of here involves not merely the omission to disclose one particular fact,[27] but the whole complex scheme whereby the Teamster defendants have conspired to cause the Teamster rank and file to invest their savings in Teamster pension funds substantially more attractive in appearance than in reality. The securities fraud here engaged in is particularly egregious because it is intentional and continuing; it is particularly striking because of the unique risk of wholesale loss in a Teamster pension fund[28] and because of the Draconian nature of the vesting requirements. See generally pp. 5-6 and n. 17 and n. 19, *supra*. For example, the Teamsters union has established a scheme of approximately 230 pension funds with (until recently) few rights of portability between different Teamster funds, knowing that worker mobility will extinguish pension rights. Gilmore Affidavit Para. 4, Pet. App. 202a. Because of the health hazards of Teamster members working in the trucking industry, and because of the economic hazards relating to worker mobility, involuntary layoffs, and mergers and acquisitions of trucking employers, most Teamster members will during their career participate in a number of different Teamster Locals and Teamster pension funds. With the lack of full scale portability, such mobility can only result in the denial of pension benefits for the Teamster rank and file—even though continually assured of the unity of the Teamster organization. See, *e.g.*, State of California, Department of Indust. Relations, *Work Injuries In Trucking—California* (1977). Furthermore, of all these Teamster pension funds, the Local 705 Pension Fund has been characterized by the IBT itself as that fund with the most stringent eligibility requirements. Gilmore Aff. Para. 10, Pet. App. 205a. In sharp contrast stands the pension fund established for the officers of the IBT—with a vesting period of only 5 years. PROD, *Teamster Democracy & Financial Responsibility* 75 (1976).

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27. See pp. 6-11, *supra*.

28. See pp. 59-60, *infra*.

The Teamster pension funds thus stand out because they typify the whole host of abuses that can develop when one has the use of other people's money. L. Brandeis, *Other People's Money* (1914). They stand out because the abuses engaged in are particularly glaring. They stand out because of the scienter underlying the fraud perpetrated against the rank and file. For this reason alone petitioners' recourse to a doomsday argument based on the worldwide retroactive liability of all pension funds is an empty embrace. In addition to a variety of other factors expressly limiting the decision below, Pet. App. p. 259a, there is absolutely no evidence of any sort that other non-Teamster pension funds have engaged in the type of *intentional* securities fraud complained of here. Following *Ernst and Ernst* v. *Hochfelder,* 425 U. S. 185 (1976), the negligent or innocent misrepresentation or omission to state a material fact about a pension fund security is not grounds for a cause of action under Sections 17(a) and 10(b) of the 1933 and 1934 Acts respectively. Petitioners' efforts to associate themselves with honest plan sponsors must, therefore, fail. Indicative of defendants' efforts to deny by any means the value of a participant's investment in a Teamster pension fund has been a use of violence found nowhere else in the pension fund industry.[29]

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29. The uniqueness of the Teamster intent to frustrate the pension claims of the rank and file is highlighted by the chilling effect of Teamster violence. See n. 17 *supra.* One striking example of this chilling effect is the unwillingness of a named plaintiff in *Dutchak* v. *IBT et al.,* No. 76 C 3803 (N. D. Ill.), a companion case consolidated with *Daniel* by the District Court below, to have his name listed in the caption other than by a "John Doe." See, *e.g.,* Raskin, *supra* n. 17, at 31 ("One after another [Teamster union member] described the high price of dissent . . . there were tales of beatings, car burnings, blacklistings, and of telephoned warnings to wives . . ."). This violence has even touched a plaintiff in the *Dutchak* case. See Dutchak Affidavit Para. 12 (two death threats received after applying for a pension from the Local 705 Pension Fund).

30. The controlling question of law certified to the Seventh Circuit and now on review here was succinctly stated by Judge Kirkland as follows:

> "The Court makes no finding here beyond the narrow holding that the Complaint alleges the sale of a security for purposes

(Footnote continued on next page.)

E. The Course of Proceedings Below.

After the filing of the Complaint on October 4, 1974, defendants Local 705 and Louis Peick moved to dismiss all Counts and defendant IBT moved to dismiss Counts I and II of the Complaint. On March 1, 1976, the District Court denied all such motions in their entirety. Pet. App. 106a; *Daniel* v. *International Brotherhood of Teamsters,* 410 F. Supp. 541 (N. D. Ill. 1976). However, on April 19, 1976, after denying defendants' motions for reconsideration, the District Court certified for immediate appeal under 28 U. S. C. Section 1292(b) its denial of the motions to dismiss Counts I and II of the Complaint.[30] Pet. App. 162a. And, on June 17, 1976, the Seventh Circuit Court of Appeals granted defendants' petition for permission to appeal. Pet. App. 199a.

The Court of Appeals for the Seventh Circuit heard the appeal on April 4, 1977, and on August 20, 1977, unanimously affirmed the District Court decision denying petitioners' various motions to dismiss Counts I and II of the Complaint. In holding that plaintiff's interest in the Local 705 Pension Fund was a "security" acquired by way of "sale" for the purposes of the antifraud rules of the federal securities laws, the Court of Appeals employed a "modality of analysis" approved by this Court. Pet. App. 217a. See generally *Ernst and Ernst* v. *Hochfelder,* 425 U. S. 185, 212-14 (1976). This modality of analysis stresses in order of attention the statutory language, the legislative history, Securities and Exchange Commission ("SEC") administrative interpretation, and economic reality and policy considerations.

1. Noting that the statutory definition of "security" in both the 1933 and 1934 Acts includes an "investment contract," the

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(Footnote continued from preceding page.)

> of application of the anti-fraud provisions of the Securities Acts, and that the Complaint alleges violations of those provisions. The Court makes no finding with respect to applicability of any other sections of those Acts to employee pension plans such as the one here litigated." Pet. App. 128a.

court applied the definition of "investment contract" as set out in *SEC* v. *W. J. Howey Company*, 328 U. S. 293, 298-99 (1946), and reiterated in *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 852 (1975), to conclude that plaintiff's interest in the Local 705 Pension Fund was a security. The first element of the *Howey* test, that there be an investment of value,

> "requires that the employer-paid contributions to the pension fund . . . be properly considered to be economic compensation to the employee. This proposition is *universally accepted by the courts and commentators.* Accordingly, the investment of money prong of the *Howey* rule has been satisfied." Pet. App. 225a. (Emphasis added).[31]

The second element of the *Howey* test, the presence of a common enterprise, is found in the Local 705 Pension Fund. And, the third element, profits from the efforts of others is also present in the form of a

> ". . . traditional return on the pension fund participant's investment, a *dollar-profit element* in the form of capital gains, interest, dividends, and other accumulated earnings realized from the trustee's management of the pension fund." Pet. App. at 227a. (emphasis added)

and by virtue of the fact that

> "It is conceded that the expected payout to a beneficiary will [otherwise] exceed the contributions made by the employer on the employee's behalf (the union member's investment). The resulting gain would commonly be termed a profit. . . . [Indeed, *it*] *is precisely this promise of retirement benefits far in excess of the pensioner's investment that forms the economic inducement to invest in a pension fund.*" *Id.* at 226a-228a[32] (emphasis added).

31. Indeed, even petitioner IBT has conceded in its brief to the Court of Appeals that Daniel's investment in the Local 705 Pension Fund "constitutes a form of compensation for employee's labor." IBT Court of Appeals Br. p. 12.

32. Petitioners also do "not contest that whatever is expected from the common venture will be solely derived from the efforts of persons *other than* the venture's investors." Pet. App. p. 226a n. 21 (emphasis added); and petitioners even concede that a substantial part of this profit—amounting variously from 9 percent to 25 percent—will derive from traditional forms of return. Compare Pet. App. 227a. with IBT Br. at 46-47.

2. Having determined that under the *Howey* test an interest in the Local 705 Pension Fund is a security, the court found support for its conclusion from an analysis of both the legislative history and SEC interpretation. For example, the court noted that a proposed 1934 amendment—which would exempt from the 1933 Act registration requirements "an offering made . . . in connection with a bona fide plan for the payment of extra compensation" to employees—was eliminated in conference because of the need of such employees for the protection provided by registration mandated disclosure. Pet. App. p. 233a. That Congress thus considered interests in employee pension plans as securities (not automatically exempt from registration) was confirmed some seven years later by then SEC Commissioner Purcell, who in commenting on the proposed 1934 amendment stated:

> "With this clear statement of Congress before it, the Commission certainly had no alternative but to interpret the act as applying to employee's plans which involve the sale of a security . . . *Any plan under which employees are given the opportunity to place part of their earnings in a fund which is to be invested for their benefit and returned to them at a later date involves the offering of an 'investment contract.'*" *1941 Hearings* (emphasis added).

More importantly, the court noted that Congress as recently as the Investment Companies Amendments Act of 1970 recognized that interests in pension funds are securities, and codified a long standing administrative practice of the SEC by exempting such interests from the registration requirements of Section 5 of the 1933 Act. Pet. App. p. 236a *et seq.* Finally, the court noted that:

> "Professors Mundheim and Henderson have characterized the SEC's interpretation of 'security' . . . as including an interest in employee pension plans *as that 'traditionally taken.'*" Id. at 235a. (Emphasis added).

3. In the next step of its analysis, the court found that its conclusion resulting from an analysis of the statute, the legislative history, and SEC interpretation—that an interest in the

Local 705 Pension Fund is a security—was consistent with both economic reality and the policy considerations underlying the federal securities law. Analogizing an interest in the Local 705 Pension Fund to an interest in both a mutual fund and a variable annuity contract, *SEC* v. *Variable Annuity Life Insurance Co.*, 359 U. S. 65 (1959) *("VALIC")*, *SEC* v. *United Benefit Life Ins. Co.*, 387 U. S. 202 (1967), the court stressed:

> "If the sole investment vehicles for tens of millions of Americans which in the aggregate control a quarter or more of the entire capital market are exempt from the antifraud provisions of the securities laws, then policing of the capital markets is significantly neutralized." Pet. App. p. 232a-233a.

4. Having determined that an interest in the Local 705 Pension Fund is a security,[33] the court next concluded that the plaintiff acquired such security by way of a "sale," because there was a "disposition for value" or "other disposition" of such security as the statutory definitions of sale in the 1933 and 1934 Acts, respectively, require. Certainly, because plaintiff has acquired an interest in the Local 705 Pension Fund, the court noted "there necessarily has been a disposition of a security to plaintiff within the scope of the two Acts." *Id.* at 242a. Furthermore, "plaintiff's giving of his services and the employer's contribution on behalf of the employee constitutes value, thereby meeting the 'for value' requirement." *Id.* Although the court noted that

> "the definitions of sale in the 1933 and 1934 Acts do not require volition . . . [i]n any case, volition is present to the extent that Local 705 members voted whether or not to accept the collective bargaining contract containing this

33. Petitioner IBT has itself conceded the presence of a "security" in the context of this case. Thus, petitioner IBT stated in its Reply Brief in Support of its Motion To Dismiss (filed Feb. 27, 1975):

> "Much of Plaintiff's argument is devoted to the proposition that interest in an employee pension plan may be 'securities' under the Federal securities laws. *This is not disputed by IBT.*" *Id.* at p. 1. (Emphasis added.)

See Pet. App. p. 233a. and n. 18.

> pension fund and whether to ratify subsequent agreements governing the level of employer contributions into the fund or seek dismissal of union officers or the unlikely radical measure of decertification of the Union." *Id.* at 244a.

5. Finally, citing the standard for pre-emption set out in *Gordon* v. *New York Stock Exchange*, 422 U. S. 659, 682-83 (1975), the court concluded that the antifraud provisions of the federal securities laws had not been pre-empted by the Employee Retirement Income Security Act of 1974 ("ERISA"). Pet. App. p. 250a. *et seq.* Indeed, Section 514(d) of ERISA specifically saves *all other federal legislation* and Section 514 (b)(2)(A) of ERISA even specifically saves *all state securities* laws. Further, defendants' confusion of the requirements of the 1933 Act's registration provisions with the antifraud provisions of the 1933 and 1934 Acts constitutes "defendants' quintessential error." *Id.* at 252a.[34]

> "The registration provisions are designed to assure that investors will be furnished with all material information concerning an informed investment decision. The mechanism to implement this objective includes filing of a registration statement and the delivery of a prospectus containing detailed information about the security and its issuer. In contradistinction, the antifraud provisions do not establish an affirmative disclosure system requiring the filing of documents. Rather the anti-fraud provisions are essentially a generalized self-executing prohibition against fraudulent activity." *Id.*

Noting that the requirements of ERISA differ from the requirements of the antifraud rules, the court thus concludes that "Reading the anti-fraud provisions of the securities laws to be

34. The court of appeals has thus noted that "the defendants concede that certain voluntary and contributory pension plans are subject to both the securities laws' registration requirement and ERISA (Rep. Br. 206). The securities laws have not torpedoed such plans. This seems to follow from the continuing registration of such plans. In fact, the disclosure requirements are becoming complementary as the SEC in its revisions of Form S-8 attempts to avoid duplication of, but not defer to the ERISA requirements." Pet. App. at 253a. and n. 54. See n. 59, *infra*.

complementary to the requirements of ERISA makes good sense." *Id.* at 254a.

Characterized as "scholarly" by Judge Tone, Pet. App. 260a, Judge Cummings' opinion comprehensively deals with every aspect of the question presented in this case. Every point raised by the petitioners is dealt with in great length. That the logic of its conclusion—that plaintiff's investment in the Local 705 Pension Fund is a "security" acquired by way of a "sale"—is soundly based and compelling becomes clear from Judge Tone's concurring opinion. Although finding the case "close and difficult," Judge Tone writing separately concurred, thereby making the decision unanimous, because of the "breadth of the definitions of 'investment contract' and 'sale' *in the statutes themselves* and the interpretation of those terms in [the authoritative] . . . cases." Pet. App. 260a. (Emphasis added.)

SUMMARY OF ARGUMENT.

The unanimous decision of the Seventh Circuit Court of Appeals holding plaintiff's investment in the Local 705 Pension Fund to be a "security" acquired by way of a "sale" pursuant to the antifraud provisions of the federal securities laws is clearly correct and should not be upset. It is soundly based on statutory analysis, legislative history, administrative interpretation, judicial precedent, and public policy. Because of the strong foundation of the decision, petitioners' efforts to overcome it are not directed to the statutory language or to the six prior Supreme Court opinions construing this language, all of which support the decision below. Rather, petitioners seek to shield themselves from liability for their intentional securities fraud, first, by denying the applicability entirely of the federal securities laws, and, second, by offering up a *concursus horribilum*. Petitioners' efforts must, however, fail. The decision below does not expand the scope of the federal securities laws. Neither should petitioners be allowed to camouflage their intentional securities fraud

through an attempted association with honest pension plan sponsors.

An interest in an employee pension plan meets the definition of "security" as set out in the 1933 and 1934 Acts and as construed by six Supreme Court decisions. That this is clearly so must be the reason petitioner IBT has itself conceded the presence of a "security" in the context of this case. See n. 33 *supra*. One form of "security" is an "investment contract," and the definition of "investment contract" was set out by this Court in *SEC* v. *W. J. Howey Co.*, 328 U. S. 293, 298-99 (1945), and re-affirmed in *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 852 (1975). The *Howey* rule requires the presence of three elements—and, after an exhaustive analysis, the Seventh Circuit has concluded that all such elements can be found here. Under the Local 705 Pension Fund (1) money is invested (2) in a common enterprise the management of which is committed to a third party and (3) from which profits and income are expected. See pp. 50-62 *infra*.

Rather than being expansive, therefore, this case is merely one of many where an accepted principle of law—the *Howey* rule—has been applied to characterize as a "security" interests in a particular scheme utilized to make use of other people's money. As "remedial" legislation, the definition of "security" is broad and has been flexibly construed. *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180, 195 (1963); *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967). As such, it was the clear intent of Congress to cast its net widely to remedy the abuses that develop when one has the use of other people's money. See n. 38 *infra*. Section 10(b) of the 1934 Act was thus drafted broadly to snare all other "cunning devices." See pp. 40-41, *infra*. And, the Local 705 Pension Fund is just such a (modern day) device intentionally used by the defendants to induce employees to invest with others the consideration they receive for labor services performed with the expectation of future profits. As Justice Brennan has noted:

"Congress need not go through the travail of re-enacting its general regulatory scheme every time a new form of enterprise is introduced, if that new form falls within the scheme's coverage." *VALIC, infra,* at 93 (Brennan, J., concurring.)

Petitioners seek to obscure this conclusion by use of various "unrealistic and irrelevant formulae." *Howey,* 328 U. S. at 301. For example, petitioners call plaintiff's interest in the Local 705 Pension Fund a "contingent expectancy"—because of the risk that plaintiff will never receive any economic benefit from the Fund. However, in so doing, petitioners ignore the fact that the risk of loss is present in any investment. Thus, the holder of an employee stock option holds a security even if the exercise right is dependent upon the employee remaining on the job for a certain length of time. See pp. 44-45, *infra.* For another example, petitioners call the Local 705 Pension Fund in which the plaintiff has invested an "involuntary non-contributory" pension fund. However, in so doing, petitioners ignore the fact that the definition of "security" is not limited by the particular form an investment vehicle takes or the name appended to it. In fact, the form of the investment vehicle here utilized takes its shape from various tax incentives—none of which change the underlying economic reality. See p. 4 n. 5 and p. 46. Indeed, economic reality here tells us that the plaintiff has acquired his interest in the Local 705 Pension Fund for substantial value. See p. 4 n. 4 and p. 47. Congress, the courts, and commentators now all agree that "regardless of the form they take, the employer's share of the cost of these plans or the benefit the employers provide are a form of compensation." S. Rep. No. 1440, 85th Cong., 2d Sess. at 4 (1958).

Petitioners, finally, offer up the "unrealistic" assertions that plaintiff, as an employee, cannot be an investor and has made no investment decision. However, there is absolutely no reason why an employee cannot also be an investor. Indeed, the term "employee-investor" was used at least as early as 1941 to characterize an employee who invests in an employee pension fund.

See n. 43, *infra.* Moreover, the investment decision undertaken by such an employee is not insignificant. On an absolute basis, it amounts to $30 per week, $1,560 per year, and over $30,000 over a 20 year career. And, on a relative basis it is probably the largest investment a Teamster union member will make in his lifetime. Drucker, *The Unseen Revolution* 13 (1976). Because the profit potential on such an investment is substantial (see p. 47), the economic lure of an investment in the Local 705 Pension Fund is hard to resist.

An investment in an employee pension plan is likely to be the customary, if not the only, investment vehicle for millions of Americans. See pp. 13-14, *supra.* As such, private non-insured employee pension funds have now become the largest investors in the capital markets. There is no reason, therefore, why working Americans should be excluded from the protection of the antifraud provisions of the federal securities laws because of the *form* of their investment vehicle. The appropriate inquiry here should not be "whether" employee pension plan securities are included, but rather "why" as a vital investment vehicle should they be excluded.

Petitioners' parade of horribles is their answer to this question. However, petitioners disclose the weakness of their position by relying on such an emotional appeal to a doomsday argument. Not surprisingly, this scare tactic cannot overcome the solid judicial reasoning of the court below. Petitioners first "horrible" is an alleged irreconcilable conflict between the federal securities laws and the newly enacted ERISA. However, petitioners inexplicably fail to note that this lawsuit involves a pre-ERISA securities fraud. See p. 97, *infra.* Because the provisions of ERISA only take effect prospectively, the plaintiff has no remedy here under ERISA.

Furthermore, even were ERISA here applicable, it would not pre-empt the federal securities laws or in any other way insulate petitioners from liability for their intentional securities fraud. Not only does ERISA specifically save all other federal legislation, it also specifically saves the applicability of *state* securities

laws to employee benefit plans. ERISA Sections 514(b)(2)(A) and (d). This conclusion is confirmed by an analysis of the legislative history of ERISA and the federal securities laws. See pp. 62-78 and 99-103, *infra*. Both Congress and the SEC have since 1934 recognized that interests in employee pension plans are securities. And, this recognition has been recently confirmed by the Investment Company Amendments Act of 1970. In fact, ERISA and the federal securities laws complement one another. ERISA does not regulate the circumstances of entry into an employee pension plan. And, even were it applicable here, ERISA would provide plaintiff *no remedy* for defendants' fraudulent misrepresentations inducing plaintiff to invest into the Local 705 Pension Fund. See p. 97 and n. 85, *infra*.

Petitioners' next "horrible" is the alleged havoc the decision below will wreak upon the nation's collective bargaining system. However, without support in either law or fact such predictions of ruin cannot withstand analysis. The decision below in no way denigrates the exclusive representative status of the collective bargaining representative. The plaintiff below does not have the right to bargain individually with his employers. What he does have is the right to vote to ratify any Local 705 labor contract with covered employers. And, this right to vote arises from the Local 705 constitution and not from this lawsuit.

Petitioners, finally, raise the "horrible" of vast dollar damages which would allegedly result from a finding of liability here. In so doing, petitioners seek to camouflage their intentional securities fraud by hiding behind the backs of honest plan administrators. The fraud complained of here involves not merely the omission to disclose one particular fact, but the whole complex scheme whereby the Teamster rank and file have been fraudulently induced to invest their savings in Teamster pension funds. The petitioners thus cannot avoid the fact that the fraud engaged in by the Teamster defendants is particularly glaring. In contrast, there is absolutely no evidence of any sort that other non-Teamster pension funds have engaged in the type of

intentional securities fraud complained of here. *Ernst and Ernst* v. *Hochfelder*, 425 U. S. 185 (1976).

In any event, the whole question of damages is not now before the Court. Indeed, this Court has clearly held that the finding of liability in a securities fraud case is unrelated to a determination of the appropriate remedy. *Mills* v. *Electric Auto-Lite*, 396 U. S. 375, 386 (1970). It is for the district court at first instance to fashion an appropriate remedy where federally secured rights are invaded. *J. I. Case* v. *Borak*, 377 U. S. 426, 433 (1964).

Petitioners, thus, seek to divert this Court's attention from their intentional securities fraud by raising the effect the decision below would allegedly have on other non-Teamster pension funds. As noted above, however, petitioners prophesize doom without support in either law or fact. The decision below does not require registration of employee pension plans with the SEC. In fact, most employee pension plans will be exempted from the registration requirements by Section 3(a)(2) of the 1933 Act. And, most of the balance will be exempted by longtime and consistent SEC administrative practice. For example, it is SEC policy to require registration only for those employee pension plans in which an amount in excess of the employers' contributions are invested in employer securities. See n. 59, *infra*. Finally, what is considered to be a sale for purposes of the antifraud rules is not necessarily a sale under the registration requirements. *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969).

The decision below is in fact a narrow opinion. It merely applies long established definitions under the federal securities laws to a particular set of facts. Indeed, the facts themselves are not really novel for petitioners concede that interests in certain employee pension plans are securities subject to the antifraud rules, as well as to the registrations requirements of the 1933 Act and ERISA. Yet, notwithstanding petitioners' fears, the application of the federal securities laws has not wreaked havoc on such plans. The petitioners have not given any good reasons why

an investment in the Local 705 Pension Fund should be treated any differently or would have any different result. The correctness of the decision below must, therefore, be affirmed by this Court in order to afford plaintiff a remedy for the intentional securities fraud practiced against him.

ARGUMENT.

I.

All of the Elements for a Cause of Action Under the Antifraud Rules of the Federal Securities Laws Are Present.

The operative provisions of Section 17(a) of the 1933 Act[35] and Section 10(b), and Rule 10b-5 thereunder, of the 1934 Act are, for purposes of this lawsuit, identical. The four principal elements which must be alleged to state a valid cause of action are:

(1) The use of the jurisdictional means, and

(2) the making of material misrepresentations, the omission to state material facts, or the use of manipulative or fraudulent devices, in connection with

(3) the sale of

(4) a security.

For the purposes of this appeal, the presence of the first two elements are not in dispute. The sole questions for determina-

35. In denying petitioners' various motions to dismiss, the District Court below held that Section 17(a) of the 1933 Act impliedly provides for a private cause of action. Although on appeal to the Seventh Circuit only Local 705 mentioned (and then in passing) the Section 17(a) argument, the Court of Appeals subsequently took the opportunity to hold that Section 17(a) does, indeed, imply a private right of action. See Local 705 Court of Appeals Br. at 21; Respondent's Court of Appeals Br. at 10 n. 21; Pet. App. 247a-250a; *Schaefer* v. *First National Bank of Lincolnwood*, 509 F. 2d 1287, 1293 (7th Cir. 1975). Now, before this Court, only petitioner Local 705 raises the issue of whether Section 17(a) impliedly creates a private cause of action. Local 705 Br. at 58-63. Respondent believes, however, that this issue is not properly encompassed within the question presented on this appeal. See p. 2, *supra*. Of course, on the issue itself this Court has reserved its opinion. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 733 n. 6 (1975). And, the Circuit courts are split on the question. Compare, *e.g.*, *Fischman* v. *Raytheon Mfg. Corp.*, 188 F. 2d 783, 787 (2d Cir. 1951) and *Schaefer*, *supra*, with *Greater Iowa Corp.* v. *McLendon*, 378 F. 2d 783, 788 (8th Cir. 1967). However, contrary to the assertions of Local 705, *Simmons* v. *Wolfson*, 428 F. 2d 455 (6th Cir. 1970), cert. den. 400 U. S. 999 (1971), only re-affirms the *Birnbaum* purchaser-seller requirement, and does not hold that Section 17(a) does not create a private right of action. *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir. 1952). In any event, logic compels the existence of a private cause of action under Section 17(a) for defrauded buyers. As Professor Loss has noted: "There is nothing novel about the doctrine of implied tort liability based on

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violation of a statute." 3 Loss, *Securities Regulation* 1785 (2d ed. 1961). Cf. *Restatement of Laws, Second, Torts 2d*, Section 286 (1965). That such a private right of action should be implied here under Section 17(a) follows from the important role the 1933 Act plays as a remedial statute in protecting the purchaser of securities from fraudulent sellers. *Tcherepnin*, 389 U. S. at 336. The preamble to the 1933 Act thus states one objective to be: "To prevent fraud in the sale [of securities]." That effective relief to a defrauded purchaser must be available is clear from this Court's reasoning in *J. I. Case* v. *Borak*, 377 U. S. 426, 432, 433 (1964):

> "While this language makes no specific reference to a private right of action, among its chief purposes is the 'protection of investors' which certainly implies the availability of judicial relief where necessary to achieve the results . . . We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."

Because such a federal statute "must be construed broadly so that it may be availed of by an injured private person," a federal court held as early as 1949 that a civil remedy exists for defrauded buyers under Section 17(a). *Osborne* v. *Mallory*, 86 F. Supp. 869, 879 (S. D. N. Y. 1949). This conclusion is all the more appropriate here where the allegation is based on fraud and where an appropriate cause of action under Section 10(b) of the 1934 Act has been established:

> "Once it had been established . . . that an aggrieved buyer has a private action under § 10(b) of the 1934 Act, there seemed little practical point in denying the existence of such a cause of action under § 17—with the important proviso that fraud, as distinct from mere negligence, must be alleged."

SEC v. *Texas, Gulf Sulphur*, 401 F. 2d 833, 867 (2d Cir. 1968) (Friendly, J. concurring), cert. den., 394 U. S. 976 (1969); see *Globus* v. *Law Research Service, Inc.*, 418 F. 2d 1276, 1283-84 (2d Cir. 1969), cert. den. 397 U. S. 913 (1970).

tion, thus, are whether an interest in the Local 705 Pension Fund is a "security" and whether such "security" was acquired by the plaintiff in a "sale".

A. The Definitions of "Security" in Both the 1933 and 1934 Acts Are Extremely Broad and Have Been Flexibly Construed.

1. The Statutory Definitions.

The term "security" has been defined in Section 2(1) of the 1933 Act to include:

> "Any note, stock, treasury stock, bond, debenture, evidence of indebtedness, *certificate of interest or participation in any profit-sharing agreement,* collateral-trust certificate, preorganization certificate or subscription, transferable share, *investment contract,* voting-trust certificate, or, in general, any interest or instrument commonly known as a 'security,' . . ." (Emphasis added).

The definition of "security" in Section 3(a)(10) of the 1934 Act also includes a "certificate of interest or participation in any profit sharing agreement" and an "investment contract", and for the purposes of this appeal may be considered "virtually identical" to the Section 2(1) definition of "security" in the 1933 Act. *Tcherepnin* v. *Knight,* 389 U. S. 332, 336, 342 (1967); S. Rep. No. 792, 73d Cong., 2d Sess. 14 (1934).

2. This Court Has Mandated That the Definition of "Security" Be Flexibly Construed.

This Court has held that the definition of security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and varied schemes devised by those who seek the use of the money of others on the promise of profits." *SEC* v. *W. J. Howey Co.,* 328 U. S. 293, 299 (1946); *Affiliated Ute Citizens* v. *United States,* 406 U. S. 128, 151 (1972).

This is in accord with the Congressional purpose behind the enactment of the federal securities laws. This purpose is "remedial." *SEC* v. *Capital Gains Research Bureau,* 375 U. S.

180, 195 (1963). Because the federal securities laws were "enacted for the purpose of avoiding frauds," this Court has stated that they must be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." *Id.* at 195. Accordingly, in applying the definition of "security" to characterize plaintiff's interest in the Local 705 Pension Fund, this Court must

> "be guided by the familiar canon of statutory construction that remedial legislation should be construed broadly to affectuate its purposes. The Securities Exchange Act quite clearly falls into the category of remedial legislation. One of its central purposes is to protect investors through the requirement of full disclosure . . . In searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality."

Tcherepnin v. *Knight,* 389 U. S. 332, 336 (1967).

The issue of what constitutes a security under the federal securities laws has been the subject of six decisions by this Court, all of which have applied the definition of security broadly and five of which have held a security to be present:

(1) *SEC* v. *C. M. Joiner Leasing Corp.,* 320 U. S. 344 (1943), holding an oil exploration program offered together with a land lease to be a security;

(2) *SEC* v. *W. J. Howey Co.,* 328 U. S. 293 (1946), holding a land sales contract for an orange grove accompanied by a service contract on the maintenance and harvesting of the orange trees to be a security;

(3) *SEC* v. *Variable Annuity Life Insurance Co.,* 359 U. S. 65 (1965), ("*VALIC*") holding a variable annuity insurance contract to be a security;

(4) *SEC* v. *United Benefit Life Insurance Co.,* 387 U. S. 202 (1967), holding a variable annuity contract to be a security even though the contract contained a guaranteed minimum feature;

(5) *Tcherepnin* v. *Knight,* 389 U.S. 332 (1967), holding a withdrawable capital share in a savings and loan association to be a security; and

(6) *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837 (1975), holding an interest in a low income cooperative housing project not to be a security because of the absence of any profit element, but stating that the touchstone of an investment contract is "the presence of an *investment in a common enterprise* premised on a *reasonable expectation of profits* to be derived from the entrepreurial or *management efforts of others*." Id. at 852.

The teaching of these cases is clearcut. First, contrary to the assertions of petitioners, the definition of "security" encompasses far more than shares of stock publicly traded and listed on a national securities exchange or otherwise traded on the established capital markets. This Court has thus noted that Section 10(b) of the 1934 Act:

> "*is not 'limited to preserving the integrity of the securities markets'* . . . , though that purpose is included . . . But, we read Section 10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase and sale of securities *whether conducted in the organized markets or face-to-face*." *Superintendent of Insurance of the State of New York* v. *Bankers Life and Casualty Co.*, 404 U. S. 6, 12 (1971) (emphasis added).

Thus, in at least four of the five Supreme Court cases finding a security present, the interests held to be investment contracts, and thus securities, were not traded on a market. Indeed, a security may be present even if it is "non-negotiable," *Tcherepnin* v. *Knight*, 389 U. S. at 343, or otherwise non-transferable. See, e.g., *Collins* v. *Rukin*, 342 F. Supp. 1282 (D. Mass. 1972) (private non-transferable option is a security). Furthermore, this Court has expressly rejected petitioners' restricted focus on the Great Depression. For example, the lower court in *Tcherepnin* noted that the securities laws "were passed in the aftermath of the great economic disaster of 1929" and therefore should be limited in application to "speculation in securities which had a fluctuating value and which were traded in securities exchanges or in over-the-counter markets." *Tcherepnin*

v. *Knight*, 389 U. S. at 345. In rejecting this argument this Court stated:

> "This statement suggests, and the respondents have argued in this Court, that the petitioners' withdrawable capital shares are not within the purview of the 1934 Act because their value normally does not fluctuate and because they are normally not traded in securities exchanges or over-the-counter. The accuracy of this assertion is open to question. But, more important, it is irrelevant to the question before us. As was observed in *Howey*, 'it is immaterial whether the enterprise is speculative or nonspeculative.' 328 U.S. at 301." *Id.*

Second, the presence of a security is not dependent upon the issuance of a document or the existence of a certificate evidencing the security. See *H. R. Rep.* No. 1838, 73d Cong., 2d Sess. 39 (1934); *SEC* v. *Addison*, 194 F. Supp. 709 (N. D. Tex. 1961); *Sire Plan Portfolios Inc.* v. *Carpentier*, 132 N. E. 2d 78 (Ill. 1956); 1 L. Loss, *Securities Regulation* 458 (2d ed. 1961). This Court has thus said in *Howey, supra*, at 299, that it is:

> "Immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise."

Consequently, an undivided interest in an investment contract scheme will be a security even if not evidenced by a written document.

The presence of a security is also not defeated by the fact that the transaction at issue involves other substantive dimensions. For example, the fact that both *Joiner* and *Howey* involved "sales of interest in land," *Joiner, supra*, at 348, does not mean that a "security" is not or can not be present. The purchaser of a security can act with more than one motive. Thus, in *VALIC* the purchaser of the variable annuity was interested both in the insurance element of benefit payments for life and in the "security" element of payments dependent on the investment performance of the variable annuity fund. Similarly, in *United Benefit Life*, this Court rejected the argument that the insurance context of the annuity contract precluded applicability of the

securities laws to the "security" part of the contract, commenting:

> "[W]e do not agree with the Court of Appeals that the contract must be characterized in its entirety. Two entirely distinct promises are included in the contract . . ." *Id.* at 207.

And, in *Forman* this Court recognized that a different case would have been presented if there had been an offer of "both a commodity or real estate for use *and* an expectation of profits." *Forman, supra,* at 853 n. 16.

Fourth, the presence of a security is not defeated by the fact that the economic interest at issue is also subject to substantive regulation by another body of state or federal law. For example, the federal securities laws were held applicable to the investment contracts present in *VALIC* and *United Benefit Life* (notwithstanding the McCarran-Ferguson Act and) even though such contracts were also subject to substantive state regulation. In like fashion, although banks are subject to extensive state and federal substantive regulation, bank securities are still securities subject to the federal securities antifraud rules, even though exempt from registration. *Tcherepnin* v. *Knight,* 389 U. S. 332 (1967). And, the Investment Company Act of 1940 provides for the substantive regulation and administration of mutual funds—while the sale of mutual fund securities still must comply with the disclosure and antifraud rules of the 1933 and 1934 Acts.

Finally, and also contrary to the assertions of petitioners, the definition of "security" is not limited to those "instruments[s] commonly known as a 'security'." This argument has been expressly rejected by this Court in *Joiner* and *Tcherepnin:*

> "Thus, the Court of Appeals read the words an 'instrument commonly known as a security' in Section 3(a)(10) as a limitation on the other descriptive terms used in the statutory definition. This, of course, is contrary to our decision in *Joiner* where we rejected the respondent's invitation to 'constrict the more general terms substantially to the more specific terms which they follow.' 320 U.S. at 350 . . ." *Tcherepnin* v. *Knight,* 389 U. S. at 343.

In fact, the definition of "security" is not limited by the particular form an investment vehicle takes or by the label[36] which it bears:

> "The reach of the Act does not stop with the obvious and commonplace. Novel, uncommon or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts' . . ." *Joiner, supra,* at 351.

In addition, therefore, to the five Supreme Court cases where a security has been held to be present, lower courts have found a myriad of diverse financial schemes and economic interests to be securities—despite the fact that, at first blush, they do not resemble the more common and traditional forms of securities.[37] Illustrative of this are the following:

(a) Promotional memberships in a yet-to-be developed country club. *Silver Hills Country Club* v. *Sobieski,* 55 Cal. 2d 811, 361 P. 2d 906 (1961);

(b) Founding memberships sold to raise capital to establish a retail store. *State* v. *Hawaii Market Center, Inc.,* 52 Hawaii 642, 485 P. 2d 105 (1971);

(c) Pyramid schemes and multi-level distributorships. *SEC* v. *Glenn W. Turner Enterprises, Inc.,* 474 F. 2d 476 (9th Cir. 1973); *SEC* v. *Koscot Interplanetary, Inc.,* 497 F. 2d 473 (5th Cir. 1974); *SEC* v. *Jet Travel*

36. "Because securities transactions are economic in character Congress intended the application of these statutes [viz., the federal securities laws] to turn on the economic realities underlying a transaction, and not on the name appended thereto." *Forman, supra,* at 849.

37. Because of the broad definition of the term "security", and of the need for a liberal construction of "security", this Court and other courts have construed "security" as bringing within the Act "many forms of transactions which, on their face do not appear to be 'securities' in the commercial sense of the word." Feldman & Rothschild, Executive Compensation & Federal Securities Legislation, 55 *Mich. L. Rev.,* 1115, 1117 (1957).

Services, Inc., 1975 CCH Fed. Sec. L. Rep. ¶ 95,317 (M. D. Fla. 1975);

(d) Assignments of oil gas leases with test drilling. *Atherton* v. *U. S.*, 128 F. 2d 463 (9th Cir. 1942); *Roe* v. *U. S.*, 287 F. 2d 435 (5th Cir. 1961); *Buie* v. *U. S.*, 420 F. 2d 1207 (5th Cir. 1969);

(e) Live silver foxes with maintenance agreement. *SEC* v. *Payne*, 35 F. Supp. 873 (S. D. N. Y. 1940);

(f) Live beavers with maintenance agreement. *Continental Marketing Corporation* v. *SEC*, 387 F. 2d 466 (10th Cir. 1967); *Kemmerer* v. *Weaver*, 445 F. 2d 76 (7th Cir. 1971);

(g) Live chinchillas for breeding. *Miller* v. *Central Chinchilla Group, Inc.*, 494 F. 2d 414 (8th Cir. 1974);

(h) Whiskey warehouse receipts. *SEC* v. *Bourbon Sales Corporation*, 47 F. Supp. 70 (W. D. Ky. 1942); *Penfield Co. of California* v. *SEC*, 143 F. 2d 746 (9th Cir. 1944); *SEC* v. *M. A. Lundy Associates*, 362 F. Supp. 226 (D. R. I. 1973); *Glen-Arden Commodities, Inc.* v. *Constantino*, 493 F. 2d 1027 (2nd Cir. 1974); *SEC* v. *Haffenden-Rimar International, Inc.*, 496 F. 2d 1192 (4th Cir. 1974);

(i) Sale of land with contract to develop citrus grove. *Blackwell* v. *Bentsen*, 203 F. 2d 690 (5th Cir. 1953); *Ferland* v. *Orange Groves of Florida, Inc.*, 377 F. Supp. 690 (M. D. Fla. 1974);

(j) Discretionary commodities futures trading accounts. *Maheu* v. *Reynolds & Co.*, 282 F. Supp. 423 (S. D. N. Y. 1967); *Berman* v. *Orimex Trading, Inc.*, 291 F. Supp. 701 (S. D. N. Y. 1968); *Johnson* v. *Espey*, 341 F. Supp. 764 (S. D. N. Y. 1972); *Marshall* v. *Lamson Bros. & Co.*, 368 F. Supp. 486 (S. D. Iowa 1974);

(k) Investments in trust deeds. *Los Angeles Trust Deed & Mortgage Exchange* v. *SEC*, 285 F. 2d 162 (9th Cir. 1960);

(l) Contract for delivery of oil by purchaser of oil royalties. *SEC* v. *Crude Oil Corporation of America*, 93 F. 2d 844 (7th Cir. 1937);

(m) Offer of contracts for sale of land. *SEC* v. *Lake Havasu Estates*, 340 F. Supp. 1318 (D. Minn. 1972).

It may well be that Congress had not considered such specific schemes prior to enactment of the 1933 and 1934 Acts. However, all are properly considered securities because of the clear intent of Congress to cast its net broadly to remedy the abuses that develop when one has the use of other people's money.[38] L. Brandeis, *Other Peoples Money* (1914). Justice Brennan has thus commented:

> "Congress need not go through the initial travail of re-enacting its general regulatory scheme every time a new form of enterprise is introduced, if that new form falls within the scheme's coverage." *VALIC, supra*, at 93 (Brennan, J., concurring).

Petitioners are, accordingly, misguided when they assert that no security is present in the instant case because the investment vehicle involved—an interest in the Local 705 Pension Fund—is (i) non-transferable and not traded on the open capital markets, (ii) an undivided interest in an investment contract scheme not evidenced by a certificate, (iii) acquired by a purchaser who is also an employee, (iv) substantively regulated by pension legislation, or (v) novel, atypical, and (allegedly) not "commonly known as a 'security'." Not to affirm the decision below for these reasons would, of necessity, call into question not only the prior six Supreme Court cases, but also the whole body of law holding novel and atypical investment contract schemes to be a security. Such a decision would be in denigration of the clear Congressional intent to enact a remedial statute governing the use of other people's money.

38. Professor Loss has thus commented: "The man who left the greatest mark on the philosophy of federal securities regulation in the country . . . was Louis D. Brandeis." 1 L. Loss, *Securities Regulation* 123 (2d ed. 1961). See, e.g., H. R. Rep. No. 85, 73rd Cong., 1st Sess. 2 (1933).

B. Public Policy Compels the Characterization of an Investment in the Local 705 Pension Fund as a Security.

The economic interest a union member has in the Local 705 Pension Fund more clearly should be characterized as a "security" than some of the exotic schemes above. Indeed, under the most elementary analyses, plaintiff's interest in the Local 705 Pension Fund plainly fits within the term "investment contract" and the term "participation in any profit sharing agreement." The security here present is an undivided interest in the Local 705 Pension Fund. This Fund consists initially of the aggregate of all monies invested on behalf of Local 705 union members by covered employers for whom such members have worked. These monies are deposited in trust with the Local 705 Pension Fund trustees, and are managed and invested in stocks, bonds, mortgages, and other investment vehicles for the sole and exclusive benefit of the Local 705 union members.

As such, the Local 705 Pension Fund is not distinguishable from the day to day mutual fund—a pool of money invested for the benefit of the mutual fund shareholders by the mutual fund investment adviser.[39] From time to time, as a Local 705 member retires or otherwise terminates his employment with a covered employer, monies are paid out from the Local 705 Pension Fund to the retiring Local 705 member. The actual amount of pay-out to any particular member will depend on a variety of factors, including, among others, the length of time such member was in covered employment, the extent of funding in the plan, and the monthly pension determined by the trustees. The success of the trustees in managing the pension monies will, in addition, be one of the most important factors in determining the amount of payout, for successful management will allow larger payments to

39. This similarity between employee pension plans and mutual funds was recognized early by the SEC. Commissioner Purcell thus testified before the House Committee on Interstate & Foreign Commerce in 1941: "Many employee plans are in the nature of investment trusts and are *indistiguishable* in legal effect from investment companies offering securities to the public at large." *1941 Hearings* (emphasis added). See pp. 12-13, *supra* and pp. 79-81, *infra*.

be made and unsuccessful management will jeopardize the participants' investment. See pp. 10-11 and n. 20, *supra*. The effect of the pension fund arrangement is that an employee invests substantial assets with the pension fund and its trustees not only during the period of his employment, but during the period of his retirement as well.

As noted above, the 1933 and 1934 Acts have as their objective, among others, to prevent fraud in the sale of securities and to protect investors. This objective of preventing fraud in the sale of securities is particularly important in the context of the role employee pension plans now play in the United States capital markets. Because employee pension plans are now the major, if not the only, form of investment for most workers in America, and because employee pension plans play a crucial role in the capital markets, they are just the type of investment vehicle Congress meant to regulate with the federal securities laws. Petitioners' argument that the decision below is "effect-oriented" thus totally misses the point. It is just the type of capital market fraud perpetrated on plaintiff here that the securities laws were designed to protect against.

Petitioners concede that no specific reference to employee pension plans is made in the language or legislative history of the Securities Act of 1933. IBT Br. at 88; Local 705 Br. at 41. This is attributed by the court of appeals to the

> "fact that in the early 1930's pension plans were still a rarity. In the early decades of the 20th century, only 38% of invested capital was invested indirectly, and of this amount only 1/10 of 1% was invested in pension funds. By 1962, the indirect sector of the capital markets had jumped to 83% and pensions constituted 27% of this amount. Hearings Before the Subcommittee on Fiscal Policy, U.S. Cong. Joint Economic Committee, 91st Cong., 2d Sess. 17-18 (1970)." Pet. App. at p. 241a.

This conclusion as to the relative unimportance of employee pension plans in the early 1930's is not overcome by petitioners' references to those plans which did exist at such time. IBT Br.

at 88-90. Moreover, petitioners fail to note that most, if not all, of such early employee pension plans were corporate sponsored plans. Most union plans were not established until after the enactment of Section 302(c)(5) of the Labor Management Relations Act of 1947. More importantly, the type of abuses now complained of just did not exist in the 1920's and early 1930's:

> "The bulk of the testimony at the 1941 hearings on the proposed amendments to the [1933] Act was devoted to . . . pragmatic and sociological matters. The most impressive is the inability of those favoring registration of pension plans to point to any abuses at the present time and remarkably few at any time. *Pension plans are adopted only by established corporations and thus cannot be used as a vehicle for the unscrupulous promotional schemes at which the Act was primarily directed.* Since the sponsors do not benefit from the funds received there is a unique absence of motive fraudulently to conceal material facts about the undertaking." Cited in Daniel Study Group, Daniel v. International Brotherhood of Teamsters, 32 *Bus. Lawyer* 1925, 1942 n. 55 (1977) (emphasis added).

See Comment, Applicability of the Federal Securities Laws to Noncontributory, Defined Benefit Pension Plans, 45 *U. of Chicago L. Rev.* 124, 127 (1977) ("relative insignificance of pension plan abuses at that time"). That is clearly not the situation now. As the facts in the instant case indicate, the pension fund vehicle is used as a fraudulent inducement to employees to invest with others the consideration they receive for labor services performed with the expectation of future profits. As a modern day investment contract scheme fraud, the Teamster pension funds are just the type of "cunning" device that Thomas G. Corcoran, a spokesman for the drafters of Section 10(b) of the 1934 Act, was concerned about:

> "Subsection (c) [Section 9(c) of H. R. 7852—later Section 10(b)] says, 'Thou shalt not devise any other cunning devices . . . of course subsection (c) is a catch-all clause to prevent manipulative devices." Hearings on H. R. 7852 and H. R. 8720 before the House Comm. on Interstate and For. Comm., 73d Cong., 2d Sess. 115 (1934).

See *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, 202-203 (1976).

The decision below thus does not expand the scope of the federal securities laws—and *the inquiry should not be "whether" employee pension plan securities are included, but rather "why" as a vital investment vehicle should they be excluded from the protection of the antifraud provisions of the federal securities laws.* Other federal statutes and state laws are not designed to remedy the type of securities fraud present here.[40]

40. Plaintiff seeks relief in the first two counts in this lawsuit—the counts now on review—for an intentional securities fraud. The fact that plaintiff's Complaint contains other counts not on review here is totally irrelevant. Such other counts involve different causes of action relating to different injuries incurred by plaintiff for which there are different standards of proof, different remedies, and different measures of damages. Indeed, the availability of relief elsewhere and on different grounds is hotly disputed by defendants. See, e.g., Local 705 Br. at 50 n. 28. For example, defendants have sought to raise various common law defenses, many of which are not available here. In any event, plaintiff should not be placed in the position of arming defendants for their defense on such other counts in order to sustain his cause of action here. Defendants obviously seek an avenue of escape elsewhere from their clear liability here. Indeed, it is likely that this lawsuit would not have been brought if plaintiff's only apparent remedy had been in state court. The counts now on review involve causes of action arising out of defendants' violations of the antifraud provisions of the federal securities laws. If plaintiff's federal right to be free of such fraud has been infringed, "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the Congressional purpose." *J. I. Case* v. *Borak*, 377 U. S. 426, 433 (1964). Furthermore, the provision of a remedy under the federal securities laws is likely to make the most efficient use of limited judicial and legal resources. This court has thus stated:

> "Since there was a 'sale' of a security and since fraud was used 'in connection with' it, *there is redress under Section 10(b), whatever might be available as a remedy under state law.*" *Superintendent of Insurance* v. *Bankers Life and Cas. Co.*, 404 U. S. 6, 12 (1971).

Contrary to the assertions of petitioners, this conclusion has not been weakened by *Santa Fe Ind., Inc.* v. *Green*, 430 U. S. 462 (1977), because there the court found an absence of any deception or manipulation—in direct contrast to the securities fraud complained of

(Footnote continued on next page.)

Indeed, the need for the type of antifraud protection found in the federal securities laws can be nowhere more clear than in the instant case. Part of the compensation which the plaintiff has received from his employment consists of employer contributions to the Local 705 Pension Fund on his behalf. As a result of these contributions, the plaintiff has built up an undivided interest in the Local 705 Pension Fund. These interests can over the years become very substantial in terms of the promised economic payout and, as such, are often the principal reason for entering and continuing covered employment for Local 705 members. Such interests in the Local 705 Pension Fund are thus relied upon by Local 705 union members for financial security in their old age. These expectations are, however, not fulfilled because of defendants' fraud. This fraud on the part of the Teamsters union is particularly egregious because it continues to this very day. The type of disclosure required to properly value a Local 705 Pension Fund security has yet to be made. Indeed, only under the federal securities laws—and not under the national labor laws or ERISA—are defendants required to make this type of disclosure. Because of the crucial importance of these economic interests to plaintiff and other Teamster union members, there is a need for full and fair disclosure of all material terms of the Local 705 Pension Fund prior to making the investment decision.[41]

(Footnote continued from preceding page.)
here. The Court in *Green* thus reaffirmed that "of course the existence of a particular state law remedy is not dispositive of the question whether Congress meant to provide a similar federal remedy." *Id.* at 478.

41. This need is not met by qualification under the Internal Revenue Code. For example, disclosure under the Internal Revenue Service rules

> does not necessarily satisfy Securities Act disclosure standards which require that the facts must be disclosed in a form which is clearly understandable to the ordinary investor.

Mundheim & Henderson at 806. Furthermore, and

> unfortunately, the Internal Revenue Code provides only limited safeguards for the security of anticipated benefit rights in private

(Footnote continued on next page.)

This need can be met under either or both the registration and antifraud provisions of the federal securities laws. Although registration of these securities is not always required, perhaps because of the burden on the issuer, there is at the minimum a clear need to provide a remedy for the type of ills complained of here:

> "Since these anti-fraud provisions do not impose an undue burden on anyone, there is no reason why they should not remain as remedies available to employees for use in cases where fraud of the kind covered by these sections has been committed." Mundheim and Henderson, Applicability of the Federal Securities Laws to Pension and Profit Sharing Plans, 29 *Law and Contemp. Prob.* 795, 814 (1964) (hereinafter referred to as *Mundheim and Henderson*).

In fact, to the extent that petitioners believe the decision below requires the registration of pension fund securities under Section 5 of the 1933 Act, they have made their

> "quintessential error . . . In contradistinction [to the registration requirements] the antifraud provisions do not establish an affirmative disclosure system requiring the filing of documents. Rather, the antifraud provisions are essentially a generalized self-executing prohibition against fraudulent activity." Pet. App. p. 252a.

SEC Chairman Williams has thus concluded that:

> "I do not believe that [applying] the antifraud provisions [to employee pension plans] will have . . . adverse consequences . . . either in terms of cost or in terms of uncertainty." Letter from Harold M. Williams to Senator Harrison A. Williams, Jr., dated Jan. 5, 1978, BNA Sec.

(Footnote continued from preceding page.)

> plans. The primary functions of the Code provisions are designed to produce revenue and to prevent evasion of tax obligations.

S. Rep. No. 1150, 92nd Cong., 2d Sess. at 4 (1972). See S. Rep. No. 93-127 in 3 *U. S. Code Cong. and Admin. News* 4841 (1974); *Truncale* v. *Blumberg,* 88 F. Supp. 677, 678 n. 1 (S. D. N. Y. 1950). Neither is this need met by filings under the old Welfare and Pension Plans Disclosure Act of 1958 or ERISA. See p. 98 n. 86 and pp. 104-107 *infra.*

Reg. and L. Rep. No. 436, p. F-1 (Jan. 18, 1978) (hereinafter referred to as *"Williams Jan. 5 Letter"*).

All that the decision below really stands for is the proposition that promoters and sellers of pension plan securities must tell the truth in their representations to buyers.

C. Economic Reality Compels the Characterization of An Investment in the Local 705 Pension Fund as a Security.

Petitioner IBT stresses and plaintiff agrees that "in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight,* 389 U. S. at 336; *United Housing Foundation, Inc.* v. *Forman,* 421 U. S. 837, 848-49 (1975). Indeed, for the employee the economic reality is that a substantial portion of his invested retirement funds are entrusted to the management of others. Economic reality compels the characterization of an investment in the Local 705 Pension Fund as a security.

Petitioners, however, seek to obscure the fundamental economic reality involved by the use of various "unrealistic and irrelevant formulae." *Howey,* 328 U. S. at 301. Thus, petitioner IBT argues that Daniel had only a "contingent expectancy" which was dependent upon his ability to meet the Local 705 Pension Fund eligibility requirements for receiving a pension payment. IBT Br. at 40. But, the same could be said with respect to many economic interests concededly considered to be securities. In many investment contract schemes, the promise of an economic return depends upon a variety of extraneous factors as well as the successful efforts of the investor. For example, the holder of an employee stock option holds a security—albeit a contingent expectancy—even if the exercise right is dependent upon the employee's remaining on the job for a certain length of time. And, in *Koscot Interplanetary, Inc., supra,* realizing a profit from the pyramid sales scheme would depend upon the successful recruitment of new prospects into the marketing plan by the initial investor. See *Glenn W. Turner Enterprises, Inc., supra,*

at 483 (profits to be earned need not solely come from the efforts of others). In *Collins* v. *Rukin, supra,* for a further example, realizing a profit from the non-transferable stock option given in exchange for services would depend upon the investor having enough money to exercise the option.

The contingent expectancy argument has thus been considered and rejected by the Court of Appeals. Pet. App. p. 224a. It derives no viability from petitioner's recitation of those outside events which may cause an investor in an employee pension plan to lose his entire investment. IBT Br. at 41-42. Indeed, the fact of such risk of loss only adds strength to the argument that a security is present,[42] and that all such risk of loss should be disclosed.

Petitioners also ignore economic reality by arguing that, as an employee, plaintiff cannot also be an investor. This argument just does not wash. There is absolutely no reason why an employee cannot be an investor or why an investment decision cannot be made at the same time as another (e.g. employment) decision is made.[43] As noted above (*supra* pp. 33-34), the underlying investment character of a security is not destroyed simply because the purchaser is acting with more than one motive. It is thus clear from this Court's decisions in *VALIC* and *United Benefit Life* that the security involved can be separated from other aspects of the transaction. In *VALIC* and *United Benefit Life,* for example, the Court separated the conventional life insurance attributes from the security involved. So here, the employment relationship entered into by plaintiff is separate from the security he has purchased There is thus no reason why plaintiff cannot be both an investor and an employee. Indeed, other

42. See pp. 59-60, *infra.* Of course, every investor in an investment contract scheme carries the risk that outside forces may cause a loss of his investment. For example, the investor in *Howey* was subject to the risk that poor weather would diminish the value of his investment.

43. The assistant general counsel of the SEC has thus termed such a participant in an employee pension plan an "employee investor." *1941 Opinion* at p. 75,387. See also the testimony of SEC Commissioner Purcell, *1941 Hearings* at 920.

courts have found no problem with this. *Collins* v. *Rukin*, 342 F. Supp. 1282 (D. Mass. 1972) (a securities fraud perpetrated for an employment motive); *SEC* v. *Addison*, 194 F. Supp. 709 (N. D. Tex. 1961); *SEC* v. *Koscot Interplanetary, Inc., supra*, at 476 ("case law countenanced the fragmented approach"). And, certainly, those employees who invest in employee pension plans which *concededly involve securities* subject to the 1933 Act registration requirements *are both employees and investors*.

It likewise confounds economic reality to argue that Daniel is not an investor because contributions were made on his behalf direct by his employers into the Local 705 Pension Fund, rather than first to Daniel and then into the Pension Fund. Indeed, as noted above (*supra* n. 5), the primary reason for this arrangement is the tax savings provided by Section 401 et seq. of the Internal Revenue Code. Certainly, petitioners do not dispute that a security would be present were that part of an employee's compensation (otherwise paid directly into a pension fund) paid first to the employee and then into the pension fund. For example, if an employee agreed to work for an employer for $100 per week plus, as a separate part of his compensation, an additional $10 per week to be paid to the employee for him to contribute to a collective pension fund, there would without dispute be a security present. The substance and economic reality is not altered if that $10 per week is paid direct by the employer into the pension fund: the employee's bargained for consideration for labor services performed is still $110 per week, $10 of which (in either case) is invested in a security.

Petitioners' attempt to weigh the relative importance of the various elements in an employee's decision is also misguided. Whether the investment decision taken by the employee-investor is primary or secondary, the fact is that an investment decision is still taken. In any event, an analysis of economic reality reveals that the investment decision here undertaken is not insignificant —on either a relative or an absolute basis. For example, the investment a Teamster member makes in the Local 705 Pension Fund is, on an absolute basis, significant in terms of its size.

Currently, this investment amounts to $30 per week, $1,560 per annum, and over $30,000 over a 20 year career. This size of an investment is surely significant and not merely incidental to an employment relationship. Indeed, such an amount invested annually for 20 years will total over $72,500 if it earns 7½ percent per year on a compound basis.[44] The profit potential is thus tremendous.

Further, on a relative scale, this investment is probably the largest investment a Teamster member will make in his lifetime. See Drucker, *The Unseen Revolution* 13 (1976); see p. 14 and n. 4, *supra*. And, finally, on an aggregate basis, employee pension plans have become a major force in the American capital markets. See p. 13, *supra*. As the sole investment vehicle for millions of Americans, economic reality compels the application of the antifraud rules of the federal securities laws to an investment in such funds.

This economic inducement is a major factor in the lure an investment in the Local 705 Pension Fund had for plaintiff. See *SEC* v. *W. J. Howey Co.*, 328 U. S. 293, 296 (1946) ("They [the investors] are attracted by the expectation of substantial profits"). Daniel "expected to receive on retirement a pension of $400 per month or more," and he was induced by the promises of defendants:

> "The purpose of these funds is to take care of you and your family in case of retirement."
>
> "These funds afford protection to you and your wife and unmarried children under eighteen years of age."

Daniel Affidavit Para. 9-10. The defendants know this and, indeed, have intentionally utilized this economic lure to its fullest. See pp. 6-7 and n. 13 *supra*. Further, as noted above, the economic lure of an employee pension plan is, notwithstanding

44. The above calculation is based on the current maximum bank interest rate of 7½ percent per annum and on the assumption that such interest earnings are allowed to accumulate on a tax deferred basis as provided in Section 401 of the Internal Revenue Code.

petitioners' unsubstantiated assertions, an important element in an employee-investor's decision making. *Id.*[45]

Finally, economic reality distinguishes this case from *Lino* v. *City Investing,* 487 F. 2d 689 (3d Cir. 1973), and *United Housing Foundation, Inc.* v. *Forman,* 421 U. S. 837 (1975). In *Lino,* the plaintiff acquired a franchise agreement in exchange for cash and several promissory notes. In holding that the notes were not securities, the court pointed out the commercial character of the transaction:

> "There was no public offering of the notes, and the issuer was the person claiming to be defrauded. The notes were not procured for speculation or investment . . . To accept [plaintiff's] . . . argument would mean that any consumer who bought an article 'on time' and issued a note [had sold a 'security'] . . ."

Id. at 695. Obviously, the facts in *Lino* have nothing whatsoever to do with the facts here. In the instant case, the plaintiff is not an issuer who issued a note to purchase an asset in a commercial transaction. Rather, Daniel has made a substantial investment by buying a security in an investment fund. *Lino* is thus inapposite.

In *Forman* the Court applied the economic reality test to hold that an interest in a state subsidized and supervised non-profit

45. If on nothing else, all of the briefs that have been filed in this case underscore the fact that the presence or absence of an employee pension plan and the terms of such a plan are of the utmost importance to an employee-investor. An employee pension plan is an important element in selling the employee on entering into employment with an employer; it is an important element in selling the employee on ratifying a collective bargaining agreement; and it is an important element in selling an employee on certifying a particular union as his exclusive representative in labor negotiations. Indeed, to the union employee, the investment he will make in an employee pension plan is as important to him as the investment an executive makes in stock options of his employer. In both cases, the fact that the investment is made by an employee—union member or executive—within an employment context does not detract from the conclusion that a security is present. See generally *Collins* v. *Rukin,* 342 F. Supp. 1282 (D. Mass. 1972).

housing cooperative is not an "investment contract" and thus not a security under the federal securities laws.[46]

Forman is thus inapposite because it does not involve the entrusting of money to others to manage with the expectation of profits. Neither does it involve a multi-employer union pension fund. Thus, in finding the interest in *Forman* not to have the requisite profit element needed for an investment contract, the Court emphasized:

> "The Bulletin [explaining the housing cooperative] repeatedly emphasizes the "nonprofit" nature of the endeavor . . . It also informs purchasers that they will be unable to resell their apartments back to Riverbay [the co-operative] at a profit since the apartment must first be offered back to Riverbay 'at the price . . . paid for it.' "

Id. at 854. The Court continued by stating: "In short, the inducement to purchase was solely to acquire subsidized low cost living space; it was not to invest for profit." *Id.*[47] Indeed, it was even *conceded* that there was "no possible profit on a resale of [this] stock." *Id.*

46. The Court also held in *Forman* that "stock" (as that term is used in the definition of "security") did not encompass the interests in the non-profit housing cooperative there at issue. In this first half of the *Forman* decision, the Court noted that the presence of "stock"— as that term is used in the definition of "security"— normally was characterized by the following common features:

> "the right to secure 'dividends contingent upon an apportionment of profits.' . . . they are . . . negotiable; they [can] . . . be pledged or hypothecated; they confer . . . voting rights in proportion to the number of shares owned; and they [can] . . . appreciate in value." *Id.* at 851.

Petitioners' reliance on these features is, however, totally misplaced because such factors merely characterize *one* form of "security" —viz., "stock"—and not the other forms set out in the definition of security—including, for example, "investment contract."

47. The other alleged elements of profit in *Forman,* including tax deductions from the payment of interest, government financed subsidies, and certain "rebates" on the rental of parking spaces and the cost of washing machines, all are obviously of a non-profit nature related to the housing acquired, unique to Forman and having nothing to do with the instant case.

Nothing could be further from the facts in the instant case. Here, the requisite profit element is present in its *traditional forms.* In fact, this is conceded by petitioners.[48] In addition, Daniel purchased his security in the Local 705 Pension Fund not with "the desire to use or consume the item purchased," *Id.* at 852, but with the expectation of substantial profit to be returned to him, together with his initial investment, in the form of retirement benefits. Indeed, it was with this economic inducement that Daniel was lured to invest in the Local 705 Pension Fund. Even in *Forman,* the Court su[illegible]gested that an investment contract might have been present [illegible] here been an offer of "both a commodity or real estate for u[illegible]n expectation of profits." *Id.* at 853 n. 16. Petitioners' relia[illegible] *Forman* is thus misguided.

D. An Investment in the Local 705 Pensi[illegible] Fund Meets All of the Elements of the Howey Rule.

An investment in the Local 705 Pension Fund is an "investment contract" and thereby included within the definition of "security" under the federal securities laws. An investment contract has been defined by the Supreme Court in *SEC* v. *W. J. Howey Co.,* 328 U. S. 293, 298-99 (1945), to mean:

> "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise."

The Supreme Court in *Forman, supra,* has repeated the *Howey* rule, stating that "this test, in short hand form, embodies the essential attributes that run through all of the Court's decisions defining a security." *Id.* at 852.

All of the elements of the *Howey* rule are present in the instant case. Under the Local 705 Pension Fund money is invested in a common enterprise, the management of which is committed

48. See p. 18 and n. 32, *supra.*

to a third party and from which profits and income are expected.[49]

1. The Investment of Money.

To establish the first element of the *Howey* rule all that need be shown is that an investment of value by the plaintiff has taken place. Whether viewed as an investment of services direct or an

49. The conflicting district court cases cited by petitioners provide no support for petitioners' position because they are either inapposite or conclusory. For example, *Hurn* v. *Retirement Trust Fund,* 434 F. Supp. 80 (C. D. Cal. 1977), can provide no support for petitioners because only two sentences in *Hurn* are directed to the issues decided in *Daniel,* and such two sentences are strictly conclusory, wtih no reasons or analyses given. And, *Wiens* v. *International Brotherhood of Teamsters,* BNA Sec. Reg. and L. Rep. No. 397 (C. D. Cal. 1977), provides no support because, as a ruling from the bench, it likewise is merely a conclusory opinion. See Pet. App. p. 247a n. 43. Both *Hurn* and *Wiens* were thus not followed by the court below. *Id.*

Robinson v. *United Mineworkers of America,* 435 F. Supp. 245 (D. D. C. 1977), similarly provides no support for petitioners because it is inapposite. There, surviving spouses and dependents of deceased coal miners sought an order declaring their right to permanent health care coverage by the defendant United Mine Workers of America Health and Retirement Funds. In holding that plaintiff's interest in such Health funds was not a "security", the court in *Robinson* expressly stated that: *"Daniel is distinguishable from the instant case."* 435 F. Supp. at 246 n. 1 (emphasis added). Given this recognition by the *Robinson* court itself, it is surprising that petitioners do not themselves see the distinction. In *Robinson*—and unlike *Daniel*—the plaintiffs as spouses and dependents of the deceased coal miners could:

> "in no sense . . . be viewed as investing in the [Health Funds] . . . since they contributed nothing to the employers in return for the employers' payment of per-tonnage royalties into the [Health Funds] . . . on behalf of and in return for the services of the union miners. The *Robinson* plaintiffs were donees instead of purchasers." Pet. App. p. 228a-229a.

More importantly, *only* the length of time health care coverage was to be extended to the plaintiffs was in issue in *Robinson.*

> "That case therefore involved merely the consumption of 'free' medical care rather than, *as in Daniel, an actual dollar financial return on investment, i.e.,* 'an expectancy of dollar benefits', *which the investor could then use to purchase anything he chose."* Pet. App. p. 229a (emphasis added).

(Footnote continued on next page.)

investment of money through the form of employer contributions made on behalf of the employee into the Local 705 Pension Fund, such an investment has here clearly been made. This proposition is now universally accepted.

Although at one time pension contributions into a pension fund by an employer on behalf of an employee were considered to be in the nature of a gift, they are now *uniformly* viewed by Congress, the courts, and the independent agencies as conceptually a part of wages. "Regardless of the form they take, the employers' share of the cost of these plans or the benefit the employers provide are a form of compensation." S. Rep. No. 1440, 85th Cong., 2d Sess. at 4 (1958). In *Inland Steel* v. *NLRB*, 77 NLRB 1 (1948), enforcement granted 170 F. 2d 247 (7th Cir. 1948), *cert. den.* 336 U. S. 960 (1949), pension and retirement plans were held to be a proper subject for compulsory collective bargaining under the Taft-Hartley Act "on the ground that, realistically viewed, such plans were part of the entire wage structure." 4 Loss, *Securities Regulation*, 2552 (1969). See, e.g., *Employing Plasterers Assoc.* v. *Journeymen Plasterers Protective and Benevolent Society*, 279 F. 2d 92, 99 (7th Cir. 1960); *Wilson* v. *Rudolph Wurlitzer Co.*, 194 N. E. 441, 443 (Ohio 1934); Note, Legal Problems of Private Pension Plans, 70 *Harv. L. Rev.* 490, 494 (1957).

Former SEC Chairman Cohen has thus commented:

> "Both [an] investor [in a mutual fund] and employee [in an employee pension plan] are *investing money which they have earned.* Realistically, the employee is simply putting into a fund for his future use that which he would otherwise get in his paycheck." (emphasis added).

(Footnote continued from preceding page.)

In contrast to *Hurn*, *Wiens* and *Robinson*, the recent district court decision in *Schlansky* v. *United Merchants & Manufacturers, Inc.*, CCH Fed. Sec. L. Rep. ¶ 96,353 (S. D. N. Y. 1977) is both directly in point and rigorous in its analysis. There, following the decision in *Daniel*, the court held that an interest in the United Merchants Pension Plan was "an investment contract as defined in *Howey* . . . acquired in a sale and subject to the anti-fraud provisions of both the 1933 and 1934 Acts." *Id.* at p. 93,212.

1972 Hearings at 231. See p. 70, *infra*. And, the noted commentator Peter F. Drucker has said:

> "Payments into a pension fund, whether made by employer, employee, or both, are 'deferred wages' and 'labor costs.' "

The Unseen Revolution at 8 and 34 (1976). Indeed, even Petitioner IBT has conceded that Daniel's investment in the Local 705 Pension Fund "constitutes a form of compensation for an employee's labor." IBT Court of Appeals Br. p. 12.

Daniel's employer contributions into the Local 705 Pension Fund represent a substantial economic portion of his wages received in return for services performed. In any event, the initial investment required may take the form of property *or services*, *SEC* v. *Addison*, 194 F. Supp. 709 (N. D. Tex. 1961), as well as cash. The commentators who have touched on this point are thus unanimous in observing that the *Howey* rule does not mandate a cash contribution. For example, in Hewitt, *Investment Contracts*, Univ. of Calif. Securities Law Institute (January, 1975) at p. 11 it is said:

> "no cases are known to seriously dispute that 'money' as used in the *Howey* test can, and does, include any item of value and not merely 'currency'. In other words, a 'cash equivalency" satisfies this first element."

See also, e.g., Hannan and Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 *Hastings L. Rev.* 219, 236 (1974) ("There seems to be no analytic reason, however, to suggest that Justice Murphy purposely excluded the investor who furnishes property or services"); and in Long, An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation, 24 *Okla. L. Rev.* 135, 161 (1971), it is said:

> "This investment is often expressed in terms of money, *but there is no requirement that it actually be paid in money.* For example, it is well recognized that stock in a corporation or an interest in a partnership can be given for services rendered or property transferred, or that such interests can be transferred for a combination of money and other

considerations. *There must be money's worth invested, but the consideration does not have to take the form of cash received.*" (Emphasis added).

The courts which have considered this point have also held that the investment of cash money is *not* required in order to satisfy the *Howey* test.[50] Any legally sufficient consideration is adequate. For example, the "investment contracts" at issue in *SEC* v. *Addison*, 194 F. Supp. 709 (N. D. Tex. 1961), were actually mere oral agreements between the defendant-employers and various workers pursuant to which the defendants employed the workers on a non-salary basis and promised the workers a share in the company's profits by reason of the defendants "extreme gratitude" for the workers' services and friendship. *Id.* at 716. There, the court held that the performance of services constituted the giving of value and that such oral agreements were, indeed, "investment contracts." *Id.* at 722. In like fashion, in *Collins* v. *Rukin*, 342 F. Supp. 1282, 1290 (D. Mass. 1972), the court held that "plaintiff's performance of service satisfies the 'value' requirement of a sale of securities." Similarly, other courts have held the investment of money element of the *Howey* test satisfied by the giving of property. See, e.g., *Ed Khadem* v. *Equity Securities Corp.*, 494 F. 2d 1224 (9th Cir. 1974) (rehypothecatable collateral); *SEC* v. *Bourbon Sales Corp.*, 47 F. Supp. 70, 73 (W. D. Kan. 1942) ("it is immaterial whether the public invests money or property in the enterprise").

Finally, this Court itself has also recognized that employer contributions on behalf of employees into an employee pension fund "are really another form of compensation to the employees, and as such the obligation [to make the contribution] . . . might be thought to be incorporated into the individual employment

50. There is abundant authority warning against too narrow a reading of the *Howey* standards. See, *e.g.*, *SEC* v. *Koscot Interplanetary, Inc.*, 497 F. 2d 473, 480 (5th Cir. 1974) ("a literal application of the *Howey* test would frustrate the remedial purposes of the Act . . . The Supreme Court admonished against such a rigid and quixotic application, . . . The admitted salutary purpose of the Acts can only be safeguarded by a functional approach to the *Howey* test.").

contracts." *Lewis* v. *Benedict Coal Co.*, 361 U. S. 459, 469 (1960).[51] In fact, unlike the instant case, the employee pension plan at issue in *Lewis* involved the United Mine Workers Retirement Fund which provided for employer contributions on behalf of the employees based on a certain sum *for each ton* of coal produced. Here, where the employer contribution is (now) $30 *per week* of employee service, the conclusion of this Court that such contributions are "compensation" to the employee is all the more clear.

Petitioners are, therefore, misguided if they read *Alabama Power Co.* v. *Davis*, 431 U. S. 581 (1977), to overturn this Court's conclusion in *Lewis*. In holding that a returning veteran is entitled to a pension as a benefit to be included within the rights of "seniority" secured by the Military Selective Service Act, this Court in *Alabama Power* did not find that such employer contributions are not "compensation" to the employee. Rather, for the sole purpose of the Military Selective Service Act, the Court considered such contributions as compensation for all the years of service of an employee rather than for any particular year.[52] In addition to the Military Selective Service Act, petitioners also cite other completely unrelated statutes, and cases interpreting them, in their vain effort to overturn the decision below.[53] Petitioners, however, strangely ignore another

51. The Court noted the following comment in Congress by Senator Taft:

> "This [i.e., the employer contributions] represents money earned by the employees."

93 Cong. Rec. 4747. See also S. Rep. No. 105, 80th Cong., 1st Sess. 52 (supplemental views).

52. The Court in *Alabama Power* thus said (at pp. 592-93):

> "It is obvious that pension payments have some resemblance to *compensation for work performed*. Funding a pension program is a current cost of employing potential pension recipients, as are wages. The size of pension benefits is a subject of collective bargaining, *and future benefits may be traded off against current compensation*." (Emphasis added.)

53. For example, *Joint Industry Board* v. *U. S.*, 391 U. S. 224 (1968), and *U. S.* v. *Embassy Restaurant*, 359 U. S. 29 (1959),

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recent decision of this Court which clearly characterizes employer contributions into employee pension plans as "compensation," and were unaware of an even more recent decision of this Court which reaches the same conclusion. *Los Angeles Department of Water & Power* v. *Manhart*, ... U. S. ...., 46 U. S. L. W. 4347, 4350 and n. 23 (April 25, 1978) ("the Department's pension benefits, and the contributions that maintain them, are 'compensation' under Title VII [of the 1964 Civil Rights Act]"); *Allied Structural Steel Co.* v. *Spannaus*, ... U. S. ...., 46 U. S. L. W. 4887, 4890-91 (June 28, 1978) (pension plan is an "additional form of compensation"); cf. *Malone* v. *White Motor Corp.*, ... U. S. ...., 98 S. Ct. 1185 (1978).

In any event, petitioners ignore in their analysis the statutory definition of "security" and "sale" under the federal securities laws, and the mandate of this Court that "the starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723

(Footnote continued from preceding page.)

hold that unpaid pension contributions in the hands of a bankrupt are not entitled to priority as "wages" under the Bankruptcy Act; and *SIPC and SEC* v. *Morgan, Kennedy & Cox, Inc.*, 533 F. 2d 1314 (2d Cir. 1976), holds that certain beneficiaries of a profit sharing trust are not "customers" of a bankrupt broker-dealer under the Securities Investor Protection Act. More relevant is the recent case of *Klamberg* v. *Roth*, CCH Fed. Sec. L. Rep. para. 95,747 at 90,630 (S. D. N.Y. 1976), where the court held that the plaintiff as beneficiary in an employee pension plan had standing by himself to bring an action against the plan trustees for violation of the antifraud rules of the 1934 Act:

> "Fraud perpetrated by a trustee in the purchase or sale of securities on behalf of the trust has a tangible impact on each beneficiary, no matter how many beneficiaries are thereby affected and regardless of the precise purposes of the trust. The policies behind the *Birnbaum* rule are not undermined. . . ."

See also *James* v. *Gerber Products*, 483 F. 2d 944 (6th Cir. 1973); *Heyman* v. *Heyman*, 356 F. Supp. 958 (S. D. N. Y. 1973). Petitioners' reliance on *SIPC and SEC* v. *Morgan Kennedy & Cox, Inc.*, is thus misplaced because it relates to an entirely different statute, the Securities Investors Protection Act of 1970. 15 U. S. C. §§ 78aaa *et seq.* Obviously, those cases dealing directly with the ability of a beneficiary to sue under the antifraud rules of the 1933 and 1934 Acts are more directly in point.

756 (1975) (J. Powell concurring). *Other statutes are irrelevant to this inquiry:*

> "The Local defendants attempt to erect a dichotomy between wages *per se* and the fringe benefits of employment which together make up an employee's total compensation by referring to sections of the Bankruptcy Act, the Internal Revenue Code, the Social Security Act, the Fair Labor Standards Act and the Sherman Act which purportedly raise such a distinction for the purposes of those Acts. *The existence of a wage/compensation dichotomy in other unrelated statutes is wholly irrelevant to whether a union member has made an investment under the Howey rule.*" Pet. App. p. 224a-225a (emphasis added).

All that need be shown is that the investments into the Local 705 Pension Fund are properly considered to be economic compensation to the employee. This is now universally accepted. Accordingly, the first element of the *Howey* rule is met.

2. The Common Enterprise.

The Local 705 Pension Fund which receives the investments of the Local 705 union members constitutes the common enterprise element of the *Howey* rule. Of course, "today, at any rate, 'where, as in a pension trust, the trust is created in connection with an employment relation . . . the trust is created for business purposes and is not non-commercial.' " 4 Loss, *supra*, at 2535-36, quoting *Mundheim & Henderson*, at 804. Moreover, an investment contract type of security may clearly take the form of an undivided interest in such a trust, see *Sire Plan Portfolios, Inc.* v. *Carpentier*, 132 N. E. 2d 78 (Ill. 1956), without issuing certificates and without permitting the transfer of interests in the trust. See *Collins* v. *Rukin*, 342 F. Supp. 1282 (D. Mass. 1972) (private non-transferable option is a security). *Mundheim & Henderson* at 803. This Court has thus held it to be "immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." *SEC* v. *W. J. Howey Co.*, 328 U. S. 293, 299 (1945). In the instant case, the Local 705 Pension

Fund trustees self-admittedly have the sole power of control over the common enterprise and the investment of all assets contained therein. Amended Trust Agreement, Article 4. Sections 1-3, Exh. 1B to Louis F. Peick Affidavit; Pet. App. p. 64a.

3. Profits from the Efforts of Others.

Finally, profits to the investors in the Local 705 Pension Fund are expected from the successful management of the monies in the Local 705 Pension Fund and in the form of retirement benefits. See, e.g., *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U. S. 65 (1959); *SEC* v. *United Benefit Life Ins. Co.*, 387 U. S. 202 (1967). Indeed, it is just this promise of profits in the form of retirement benefits far in excess of the plaintiff's investment that formed the *economic inducement* to plaintiff to invest in the Local 705 Pension Fund. The profit to plaintiff here is a *dollar* profit for these retirement benefits are dollar benefits. Moreover, this profit is substantial both on an absolute and relative basis. See pp. 46-47, *supra.*

Petitioners complain that such profits are, alternatively, fixed by the trustees of the pension fund or determined by the life expectancy of the employee. IBT Br. at 44, 47. However, that the level of retirement benefits per month is fixed by the trustees —from time to time—does not eliminate the element of profits. This Court has thus observed in *Howey* that "it is immaterial whether the enterprise is speculative or nonspeculative." *Howey*, 328 U. S. at 301. Furthermore, the total expected payout for a Local 705 union member will greatly exceed the aggregate of such member's investment in the Local 705 Pension Fund—and to a substantial extent this excess will be a profit element in the form of capital gains, interest, dividends, and other accumulated earnings realized from the (hopefully) successful management of the Fund.[54] In any event, the profit element need not even be

54. That this profit element is fixed is also, of course, no different from a fixed interest rate on a debenture or bond—or from a fixing of profits through the establishment of a repurchase guaranty at a price equal to the original purchase price plus a set percentage in an

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a financial profit. *Silver Hills Country Club* v. *Sobieski*, 361 F. 2d 906 (Cal. 1961) (use of club facilities).

Furthermore, the fact that the total profit to the investor in the Local 705 Pension Fund is determined on the basis of actuarial assumptions and the investor's actual life span no more eliminates the presence of such profits here than in *VALIC*. *VALIC, supra*, at 70. There, the total payout to the annuitant was (as here) determined on the basis of actuarial assumptions and the annuitant's actual life span.

> "His [i.e., the annuitant's] rights are technically assignable, but practically unmarketable since *they depend on his individual life span.*" *Id.* at 89 (J. Brennan, concurring) (emphasis added).

Petitioners also complain that the retirement benefits paid to the investor in the Local 705 Pension Fund are received only subsequent to vesting by employment with covered employers for the requisite period of time. But, as noted above (at pp. 44-45), this, too, does not eliminate the element of profits.

In addition, as with any investment in a security, there is a risk of loss.[55] The benefits due the plaintiff are not insured. See

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investment contract transaction. See, *e.g.*, *Longines Symphonette Society*, [72-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,151 (1972); Coffey, 18 *West Res. L. Rev.* at 401.

55. The presence of such risk is an important factor to consider in the present inquiry:

> "The concept of risk is central to any capitalist economy. The profit received by those who assume risk . . . is the economic equivalent of the return on other major factors of production."

Note, the Regulation of Risky Investments, 83 *Harv. L. Rev.* 603 (1970). The presence of profits is, therefore, just the other side of the coin to the presence of risk. See *Webster's New Collegiate Dictionary* 919 (1973) (profits are "the compensation accruing to entrepreneurs for the assumption of risk . . .") Furthermore, the so-called "risk capital theory" was not rejected by this Court in *Forman*, for there the Court only declined to apply the "risk capital" approach in that case—noting that, even if applicable, the buyer of the alleged securities there "take no risk in any significant sense." *Forman* at 857 n. 24. The Court thus did not reject the risk capital approach as improper.

El Khadem v. *Equity Securities Corp.*, 494 F. 2d 1224 (9th Cir.), *cert. den.*, 419 U. S. 900 (1974); *Silver Hills Country Club* v. *Sobieski, supra.* If the Local 705 Pension Fund trustees are unsuccessful money managers, or if they countenance abuse or fraud in the management of the trust assets, the plaintiff will not receive the return expected. Indeed, the plaintiff may lose all or part of his initial investment in the Local 705 Pension Fund. Thus, reports in a highly reputable financial newspaper indicate that this may well be the case with at least one Teamster pension fund:

> "As of Feb. 29, 1972 . . . the [Teamsters Central States, Southeast and Southwest Areas Pension Fund] . . . listed total assets of $917.9 million, of which $819 million, or 89% was either already invested or firmly committed to real estate loans—against less than 5% for the average similar fund, according to a survey in 1973 by the Securities and Exchange Commission . . . Moreover, it wasn't all prime real estate. For one thing, much was invested in second and even third mortgages . . . As of 1972 at least, it wasn't coming up roses, not for the half million Teamsters relying on the fund for their retirement income, anyway. The fund records state that real estate deals accounting for 30% of these mortgage loans were delinquent, not including properties acquired by the fund from borrowers, presumably in lieu of payment. With these properties thrown in, it appears that some 36.5% of the real estate loans were coming a cropper." *Wall St. J.*, Thursday, July 22, 1975.

Consequently, the plaintiff and other Local 705 union members bear a substantial element of risk in this major investment in the Local 705 Pension Fund.

Petitioners finally attempt to discredit the profit Daniel expects to receive from his investment in the Local 705 Pension Fund by tracing its source and claiming the profit derives from the forfeited pensions of other union members. However, this attempt must fail. First, Petitioner's *own* description of the Local 705 Pension Fund to its members stresses the earnings on the contributions paid into the Fund by each member's employer:

> "Pensions are paid for out of the Employer contributions *for each covered Employee-member employed by him . . .* The actuaries take into consideration the amount of money which a covered Employer has contributed to the Fund in 20 years and then determine *how much more money the Fund will have to earn on that contribution in order to be able to make the monthly payments required under the Plan . . . without this income growth the Fund could not accumulate enough money to pay the $250.00 monthly pensions provided in the Plan.*" Pet. App. 70a at p. 14-15 (emphasis added). See p. 11, *supra.*

Second, the source of gain is irrelevant to the presence of profits. Profits exist when the return received, regardless of their source, exceeds the investment. Thus, profits are defined in *Black's Law Dictionary* at 1376 (1957):

> "An excess of the value of returns over the value of advances."

And, in *Webster's New Collegiate Dictionary* at 919 (1973):

> "The excess of returns over expenditures in a transaction."

Because the expected payout to Daniel is *conceded* to exceed Daniel's investment in the Local 705 Pension Fund, the profit element of *Howey* is satisfied by this fact alone. For example, in both *SEC* v. *Koscot Interplanetary, Inc., supra, and SEC* v. *Glenn W. Turner Enterprises, Inc., supra,* the profit there present for any particular investor in the pyramid sales scheme had as its source a substantial part of the investment of another investor in the scheme. Likewise, the payout to an annuitant in *VALIC, supra,* could well come from the investments of and fees charged new annuitants rather than from a return to the maturing annuitant of his original investment and the income earned on it. *Id.* at p. 89.

Third, and most important, even if part of the profits to an investor in the Local 705 Pension Fund derives from forfeited investments of other investors,[56] the fact remains that a sub-

56. Petitioners' argument in essence is an attempt to utilize its fraud as a shield from liability. Thus, if petitioners fraudulently

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stantial part of the profits also derives from *traditional earnings* on the Local 705 Pension Fund participant's investment. Thus, as calculated above, the investment of $1,560 per year in the Local 705 Pension Fund for 20 years should earn over $42,500 in hard dollar profits over and above the investor's total $30,000 investment. In fact, petitioners *concede* that traditional forms of return make up part of the profit to an investor in the Local 705 Pension Fund, but go on to argue that the amount which they constitute is insignificant. IBT Br. at 46-47. However, even on the basis of petitioners' own arithmetic, the traditional profit element ($5,032) amounts to over 52 percent of the total amount invested ($9,510). *This is not insignificant.* The profits promised to Daniel in the form of retirement benefits are substantial. They constitute the economic "carrot" used to induce Daniel to invest substantial sums into the Local 705 Pension Fund from its inception until his retirement.

E. Both Legislative History and SEC Interpretation Support the Characterization of an Interest in the Local 705 Pension Fund as a Security.

That an economic interest in the Local 705 Pension Fund should be characterized as a "security" is supported by both legislative history and SEC interpretation.

1. The Rejection of the 1934 Amendment to the 1933 Act.

In 1934 the Senate adopted an amendment to the 1933 Act which provided that:

> "An offering made solely to employees of an issuer or its affiliate in connection with a bona fide plan for the payment of *extra compensation or* stock-investment plan for the exclusive benefit of such employees. . ." 78 Cong. Rec. 8708 (1934) (emphasis added)

(Footnote continued from preceding page.)

deny a pension to most investors, and if, as a result, most of the profits derive from the forfeited investments of other investors, all that has been established is petitioners' own fraud.

would *be exempt from registration.* See *1941 Hearings* at 895. This amendment, therefore, would apply not only to stock-investment plans—as petitioners would so limit it—but also to employee plans for the payment of *extra compensation,* such as the more common employee pension plan designed to invest employee funds in a variety of different types of assets. In any event, the Senate adopted amendment was eliminated in conference on the ground that participants in such plans "may be in as great need of protection afforded by availability of information concerning the issuer for which they work as are most other members of the public." H. R. Rep. No. 1838, 73d Cong., 2d Sess. at 41 (1934). And, Senator Hastings himself, the sponsor of the amendment, stressed the "additional compensation" language—and not the "stock investment plan" language—when complaining on the Senate floor as to the conference rejection:

> "I do not see why the Federal Government should insist upon having anything to do with the plan of a corporation which decides that, as part of its policy, it will give certain *additional compensation* or bonus to its employees." 78 Cong. Rec. 10181 (emphasis added).

That Congress thus considered interests in employee pension plans as securities (which should not automatically be exempt from registration) and that the SEC so understood this was emphatically pointed out some seven years later by then SEC Commissioner Purcell. In commenting on the proposed 1934 amendment and its rejection in conference, Commissioner Purcell stated:

> "In addition to the detailed language of the act itself, there is legislative history which has made it *quite apparent to the Commission that Congress intended investments in employees' plans to be included within the term "security."* You may remember that among the proposals for amending the Securities Act which were advanced in 1934 there was one which would have exempted from registration . . .
>
> > an offering made solely to employees of an issuer or its affiliates in connection with a bona fide plan for

the payment of extra compensation or stock-investment plan for the exclusive benefit of such employees.

My recollection, so far as that amendment is concerned, is that it was adopted in the Senate and went to conference. The proposal was eliminated by the conference committee. . . . *With this clear statement of Congress before it, the Commission certainly had no alternative but to interpret the act as applying to employees' plans which involve the sale of a security.*" *1941 Hearings* at 895-96 (emphasis added).

A more clear exposition of the meaning of this proposed amendment and its rejection could not have been made.

2. The 1941 Opinions.

In September, 1941, the SEC published two opinions of Assistant General Counsel John F. Davis. [1941-44 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 75,195 (1941) (hereinafter referred to as *"1941 Opinion"*). Contrary to petitioners' assertion, however, these opinions deal primarily with the question of whether interests in employee pension plans must be registered under the 1933 Act. For example, in response to the initial inquiry the First Opinion begins:

"The Commission has not issued any new ruling with respect to *the registration of interests* in employees' pensions or profit-sharing plans. The Commission has always taken the position that the offer or sale of interests in certain types of voluntary, contributory plans is *subject to the registration and prospectus requirements* of the Securities Act of 1933, unless one of the general exemptions in Sections 3 and 4 of the Act is available . . .

The question of *registering interests* in employees' benefit plans has been considered in connection with discussions during the past few months looking toward amendment of the Securities Act in other respects. . . As a result of discussions with representatives of various interested persons, the Commission intends to recommend to the Congress as a part of the current revision program certain amendments to the Securities Act which it is hoped will *avoid the necessity of meeting the full registration requirements* in offering and selling interests in certain types of plans. The Commission is seeking to achieve this objective without at the same time relaxing the safeguards of the Act in *those situations in which employee investors are in need of protection.*" *Id.* at pp. 75,386-87 (emphasis added).

And, the Second Opinion sets out the so-called "no-sale" rationale as justification for not requiring registration of compulsory and non-contributory employee pension plans. What is important for our purposes here, however, is the fact that the Second Opinion makes it clear that an interest in an employee pension plan is a security:

"You are correct in surmising it to be our position that the security which is involved within the meaning of Section 2(1) of that Act in connection with the offer or sale of interests in certain types of [employee pension] plans is normally an 'investment contract.' Frequently the interests may come also within the phrase 'certificate of interest or participation in a profit-sharing agreement." *1941 Opinion* at p. 75,387.

3. The 1941 Hearings.

In June, 1941 Congressman Paddock introduced a bill, H. R. 5065, which would exclude from the definition of security

"any interest (or any instrument representing such interest) of employees arising out of or resulting from the creation or operation of *any* employees' stock bonus, pension, or profit sharing trust which meets the conditions of Section 165 [now Section 401] of the Internal Revenue Code . . ." *1941 Hearings* at 919 (emphasis added).

Of course, had Congress never intended pension plans to come within the definition of "security," this proposed bill would have been unnecessary.

The SEC opposed enactment of this bill. That the SEC clearly considered interests in all pension plans to be securities and *that such securities are subject to the antifraud provisions of the securities laws* is revealed in its comments on H. R. 5065:

"Although the Commission believes that in general employees' plans are highly desirable, it believes also that there are many plans as to which employees are entitled to assurance that there will be disclosed to them the essential facts concerning their payments, how those payments will be invested, and the conditions upon which they will be returned. . . In addition, H.R. 5065 would not only exempt employees' plans generally from the registration provisions of the act, ***but it would also deprive employees of the protection afforded them by the fraud provisions of the statute.*** Even if it be assumed that there are situations in which the protection of employees does not justify the expense of registration, it hardly follows that employees should be denied a right under the act to recover from employers who have actually deceived them. Under the act no securities at all, not even Government securities, are exempted from the fraud provisions of section 17(a). Only Government securities are exempted from the civil liability provisions of section 12(2). ***The Commission knows of no reason why employee-investors should be singled out from all other investors for discrimination in this respect.***" SEC, Proposals For Amendments To the Securities Act of 1933 and the Securities Exchange Act of 1934, H.R. Comm. Print, 77th Cong., 1st Sess. at 15 (1941) (hereinafter referred to as "*1941 SEC Report*") (emphasis added).

This unambiguous declaration was repeated in the Congressional hearings on H. R. 5065 and related bills[57] by SEC Commissioner Purcell. *1941 Hearings* at 920.

SEC Commissioner Purcell also clearly stated in the *1941 Hearings* that the definition of "security" included interests in employee pension plans:

57. In contrast to Congressman Paddock's proposal that interests in *all* employee pension plans be excluded from the definition of "security," the SEC proposed that certain employee pension plans (where the employee-investors' interests were better "safeguarded") be automatically exempt *from registration,* that other employee pension plans be subject to an exemption *from registration* by SEC rule, and that the balance remain subject to the registration requirements. *1941 SEC Report* at 15.

"You will notice that section 2(1) includes in the definition of 'security' not only stocks, bonds, notes and other securities, but specifically 'investment contracts.' Now, any plan under which employees are given the opportunity to place part of their earnings in a fund which is to be invested for their benefit and returned to them at a later date involves the offering of an 'investment contract.' In fact, many employee plans are in the nature of investment trusts and are indistinguishable in legal effect from investment companies offering securities to the public at large . . .

Employees' retirement and pension plans also involve investing an employee's earnings with the intention of returning them to him at a future date. It has not appeared to the Commission that it was possible to distinguish investments in these plans from other securities, so far as the registration requirements are concerned, merely because the repayment is made in installments, which is sometimes the case, rather than in a lump sum, which is usually the case in the purchase of a security of another type." *1941 Hearings* at 895 (emphasis added).

In making this statement Commissioner Purcell has in no way limited his remarks to any particular type of pension plan. Daniel has been given the opportunity to place his earnings in the Local 705 Pension Fund, to be invested for his benefit and returned to him in the future. The fact that his compensation is placed in the Fund direct by his employer is a quirk of the tax code and is not in derogation of his rights under the federal securities laws.

Commissioner Purcell clearly opposed the H. R. 5065 proposal that interests in *all* tax qualified pension funds (such as the Local 705 Pension Fund) be excluded from the definition of security. *1941 Hearings* at 920. He has clearly stated that, since the Congressional rejection of the proposed 1934 Amendment to the 1933 Act, the SEC has considered the federal securities laws to apply to interests in all employee pension plans. *1941 Hearings* at 896. The major thrust of his testimony, however, focused on when registration is required for such employee pension plans. As noted above (see n. 57), in 1941 the

SEC proposed amending the registration requirements in a way to meet this problem. And, indeed, even petitioner IBT has conceded that "Mr. Purcell's testimony focused on the registration requirements of the Act." IBT Br. at 110. Unfortunately, however, this focus has blurred petitioners' reading of this testimony. Petitioners' references to certain statements of Commissioner Purcell in the *1941 Hearings* and to the *1941 Opinion* are misleading because they are taken out of context: such statements were made in the context of whether all employee pension plan interests had to be registered under the 1933 Act. Thus, for example, Commissioner Purcell has stated:

> "Now, in anything that I have said, I do not mean to imply that every employees' plan requires registration. It is only those plans which involve the *sale* of an investment contract or some other type of security. . . Moreover, *even where the plan involves securities, registration is not required* in the many cases where the employees pay nothing for the securities, but receive an interest in an investment fund by way of bonus from their employer; for, of course, a gift is not a sale, and the Securities Act is concerned only with sales of securities. . .
>
> Similarly, compulsory plans *do not require registration*. If a plan is so set up that participation in it is a condition of employment, the Commission has taken the position that, as in the case of a noncontributory or bonus plan, there is no sale involved." *1941 Hearings* at 895 (emphasis added).

Such a clear statement that compulsory, non-contributory pension plans do not need to register under the 1933 Act because there is no-sale *for registration purposes* need not have been made had Commissioner Purcell thought that interests in such plans were not securities.[58] Thus, although certain employee

58. Petitioners' reliance on statements by Congressman Wolverton in the *1941 Hearings* is equally misplaced. See Pet. App. p. 235a n. 32. Such statements reflected his concern that the amendments proposed by the SEC—setting out the "rigid" (*Mundheim and Henderson* at 811) conditions to be met by an employee pension plan to qualify for an automatic exemption from the registration requirements (and reproduced in *1941 Hearings* at 908)—would

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pension plans may or may not be subject to the 1933 Act registration requirements, the SEC interpretation that all such plans involve the presence of a security is both consistent and clear. Of course, this lawsuit expressly does not involve a violation of the registration requirements.

4. SEC Administrative Interpretation.

As noted above, the consistent interpretation of the SEC since the rejection of the 1934 amendment has been that an interest in an employee pension plan is a security. Petitioners' are just, plain wrong when they assert that the SEC only recently has adopted this view. Furthermore, at no point has the interpretation of the SEC been limited to any one particular type of employee pension plan. Petitioners have nowhere pointed out any statement by the SEC that interests in the so-called compulsory, non-contributory employee pension plans are not securities. Rather, the position that interests in all employee pension plans constitute "investment contracts" or "certificates of interest or participation in a profit sharing agreement" has been characterized as that "traditionally taken" by the SEC. *Mundheim and Henderson* at 801.

(Footnote continued from preceding page.)

put the SEC into the *substantive* business of regulating the internal workings of employee pension plans. For example, Congressman Wolverton stated:

> "By the Securities Commission getting into that field of *regulation*, it seems to me it is getting away beyond what the title of the Securities Act intended. . . . I cannot see the propriety of the basis upon which you are working in all this *pension regulation* into the Securities Act." *1941 Hearings* at 911 (emphasis added).

See also, *e.g.*, *1941 Hearings* at 912 ("Do you have any power in the Commission now to *direct* investments [of employee pension plans] in that type of securities?"). In response, Commissioner Purcell, not surprisingly, disavowed any such attempt in the SEC proposals to regulate in this fashion:

> "I am sorry, sir, to have to repeat again that we are not attempting any *regulation*. We are merely attempting to set standards for exemption from meeting the [*registration*] requirements of the Act." *Id.* at 911 (emphasis added).

This traditional position of the SEC has been confirmed by Manuel F. Cohen, former chairman of the SEC, who has stated categorically:

> "The first and perhaps the most important point I can make to this subcommittee [is that] . . . *Pension plans represent an investment medium.* Interests in a private pension plan *fall within the definition of a security* under the Securities Act of 1933, and most private pension plans would be subject to regulation under the Investment Company Act of 1940 but for a specific exemption from that statute. . ." *1972 Hearings* at 251 (emphasis added).

Chairman Cohen continued by outlining the *similarities* between employee pension plans and mutual funds, quoted above at pp. 12-13. Then, Chairman Cohen made it quite clear that his remarks *included* compulsory, non-contributory employee pension plans, such as the Local 705 Pension Fund involved here:

> "Unlike the mutual fund investor, the employee's investment is usually mandatory. It comes with the job—that is, where it exists . . . Unlike the mutual fund investor who can demand the return of his investment at any time, the employee must leave his job under certain specified conditions before he has a right to the return of his investment and of his interest in the contributions of his employer made for his benefit." *Id.*

Former Chairman Cohen also included in the record of the *1972 Hearings* Chapter VIII of the Summary Volume of the *Institutional Investor Study* (1971) which states quite clearly that:

> "Interests of participants in [employee pension] plans meet the definition of 'security' under the Securities Act of 1933." *Id.* at 69.

That this conclusion also covers the type of multi-employer pension plan at issue here is also made clear in the Summary Volume of the *Institutional Investor Study* at 70 ("multiemployer pension-benefit plans generally are subject to all of the above legal provisions and must *in addition* comply with the provisions of the Taft-Hartley Act. . .) (emphasis added), and

in the full study report at p. 996 ("employees' interests in [compulsory non-contributory] . . . plan . . . recognized to be 'securities'.").

Perhaps the most telling point is that petitioners concede certain employee pension plans are subject (both to ERISA and) to the federal securities laws. Petitioners acknowledge that certain "voluntary and contributory" pension plans are subject to the antifraud rules as well as to the registration requirements of the 1933 and 1934 Acts.[59] Yet, the fact that these admitted securities—including that portion attributable to the employers' direct contributions—are sold in an employment context periodically over the employee's career has not generated any demand that they be excused from the requirements of the federal securities laws. Rather, SEC administrative practice here merely confirms the SEC position that interests in all employee pension plans are securities. Other plans, although perhaps not subject to the registration requirements, are not considered by the SEC not to involve the presence of a "security".[60]

59. A participant's interest in an employee pension plan in which an amount in excess of the employer's contribution is allocated to the purchase of securities issued by the employer or by a company, directly or indirectly, controlling or controlled by, or under common control of, the employer, must be registered under the 1933 Act, usually on Form S-8, a short registration form developed for this purpose. More importantly, the interest which is so registered includes the employer's contributions as well as the employee's contribution. In addition, any such employee pension plan must comply with ERISA, and be qualified under Section 401 and other relevant sections of the Internal Revenue Code. See Letter of the Assistant Director, Division of Corporation Finance, SEC, to CCH, CCH Fed. Sec. L. Rep. ¶ 2105.51 (May 12, 1953); Letter of the Chief Counsel, Division of Corporation Finance, SEC, to CCH, CCH Fed. Sec. L. Rep. ¶ 2105.52 (August 1, 1962).

60. SEC Commissioner Harold M. Williams has thus recently stated:

> "Much the same approach has been taken by the Commission with respect to the applicability of the Securities Exchange Act to pension plans . . . Reflecting the Commission's views that interests in pension plans are securities—but should not be the subject of regulatory requirements otherwise applicable to such securities—the Commission, in 1965, specifically

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5. The 1970 Amendment to the 1933 Act.

Petitioners place great reliance on their interpretation of the Investment Companies Amendments Act of 1970 (the 1970 Act). However, the 1970 Act only goes to confirm the understanding of Congress that interests in employee pension plans are securities. In the 1970 Act, Congress—specifically recognizing that such interests are securities—provided for the exemption of certain of those securities from the *registration* requirements of Section 5 of the 1933 Act:

> "Section 3(a). Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities: . . .
>
> (2) . . . any interest or participation in a single or collective trust fund maintained by a bank . . . which interest or participation is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under Section 401 of [the Internal Revenue Code of 1954] . . ."

Section 3(a) of the Securities Act of 1933.[61] Consequently, if an employee pension trust fund is maintained at a bank, the interests in such a fund are securities which are exempt from registration. *Indeed, because most employee pension funds are bank maintained, registration is not required for most employee pension funds.* On the other hand, if an employee pension fund is maintained elsewhere, the clear Congressional implication[62]

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> exempted pension plans, as issuers of securities, from the need to file periodic reports. That exemption is codified in Securities Exchange Act Rule 12h-2(a)."

Statement of SEC Chairman Williams before the Subcomm. on Labor of the Senate Comm. on Human Resources, (Oct. 11, 1977) (hereinafter referred to as "*Williams Testimony*").

61. The 1970 Act provided for a similar amendment to the 1934 Act definition of exempted security. See Section 3(a)(12) of the Securities Exchange Act of 1934; Pet. App. p. 237a n. 34.

62. The Supreme Court has thus noted in *Tcherepnin* v. *Knight*, 389 U. S. 332, 341 (1967), that Congress would not have granted

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is that interests in this fund are securities which are not automatically exempt from registration. In either case, however, the interests in such an employee pension trust fund are securities.

Petitioners' attempt to restrict the clear language of the 1970 Act is clearly wrong. First, although the 1970 Act was designed to deal with a variety of problems, the applicability of the 1970 Act to bank common trust funds and to so-called H. R. 10 self employed retirement funds is dealt with in *other* language in amended Section 3(a)(2) and elsewhere in the Investment Company Act of 1940.[63] Consequently, Section 3(a)(2), as amended by the 1970 Act, deals with the exemption from registration of both interests in employee pension plans *and* interests in bank common trust funds. Second, the language itself of Section 3(a)(2) of the 1933 Act, as amended by the 1970 Act, clearly refers to "any interest or participation in a single . . . trust fund . . . which interest or participation is issued in connection with . . . a pension plan." This is an exact description of the interest plaintiff has acquired in the Local 705 Pension Fund.

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an exemption from the registration requirements for a withdrawable capital share issued by a savings and loan association "unless there was a general agreement that the Act's definition of security in § 2(1) brought building and loan shares within the purview of the Act."

63. Section 3(a)(2) of the 1933 Act thus also provides:

> "Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities . . . (2) . . . any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian . . . The Commission, by rules and regulations or order, shall exempt from the provisions of Section 5 of this title any interest or participation issued in connection with a stock bonus, pension, profit sharing, or annuity plan which covers employees some or all of whom are employees within the meaning of Section 401(c)(1) of the Internal Revenue Code of 1954, if and to the extent that the Commission determines this to be necessary or appropriate in the public interest and consistent with the protection of investors . . ."

See also Section 3(c)(11) of the Investment Company Act of 1940. 15 U. S. C. Section 80a-3(c)(11).

Petitioners' efforts, moreover, to make something of the difference between a pension "fund" and a pension "plan" are without meaning here. IBT Br. at 126. The Local 705 Pension Fund is, as petitioner Local 705 indicates, a *trust fund* created by a trust agreement. Local 705 Br. at 6. See Trust Agreement Creating the Local 705 International Brotherhood of Teamsters Pension Trust Article 2, "Creation of Trust Fund," Pet. App. p. 62a. And, Daniel's acquisition of an interest or participation in this trust fund constitutes his investment at issue here.

This conclusion is not altered by petitioners' focus on the phrase "maintained by a bank." The meaning of this phrase relates to the extent of the role which a bank might play with respect to any such trust fund. This is made clear from the House Committee Report on amended Section 3(a)(2) which uses the words "bank administered" in describing this section. Report of the House Comm. on Interstate and For. Comm. on the Investment Companies Amendments Act of 1970, H. R. Rep. No. 1382, 91st Cong., 2d Sess. at 10 (1970) (hereinafter referred to as "1970 Act House Report"). As a further example, since 1971 the SEC has interpreted the phrase "maintained by a bank" to require the bank to be more than a "mere custodian" for the funds held in trust, see, *e.g., Bank of America,* [71-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,614 (1971); *Sterling National Bank and Trust Co.,* [75-76 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 80,433 (1976); but that the bank can have less than full investment powers. See, *e.g., Northeast Bancorp, Inc.,* [77-78 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 81,293 (1976); *Gilbert Assoc., Inc.,* [77-78 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 81,406 (1977).

In the instant case, the Local 705 Pension Fund may well be maintained by a bank. If so, the interests involved will be securities exempt from registration. Of course, exemption from registration does *not* mean exemption from either Section 17(a) of the 1933 Act or Rule 10b-5 of the 1934 Act. Although petitioners correctly note the manifold objectives of the 1970 Act, they cannot ignore the clear statement of Congressional intent:

> "[This section] would exempt . . . bank . . . *administered* corporate pension plans from the registration and reporting requirements of the Federal Securities Act, *but it does not exempt them from the antifraud provisions of those acts.*" 1970 Act House Report at 10 (emphasis added).

See Section 17(c) of the 1933 Act. This Congressional conclusion would, *a fortiori,* be even stronger with respect to pension plans not exempt from the registration requirements because they are individually, rather than bank, administered.

Petitioners at great length delve into the legislative history of the insertion of the phrase "single or" into amended Section 3(a)(2). In so doing, petitioners mistakenly assert that amended Section 3(a)(2) was designed to exempt from registration only the sales of interests in certain bank trust funds to the underlying pension funds and not the sales of interests in the underlying pension funds to its employee-investors. Such an argument can provide no support for petitioners. First, as noted above, the clear language of amended Section 3(a)(2) covers an interest in the Local 705 Pension Fund trust fund and not some separate bank trust fund in which the Local 705 Pension Fund may invest. Whether the Local 705 Pension Fund is exempt from registration pursuant to Section 3(a)(2) thus depends on the degree of bank "administration" of such Fund.

Second, it makes better common sense to read the "single . . . trust fund" phrase to apply to the underlying pension fund and not to a bank trust fund sold to an underlying pension trust fund. Otherwise, the question would be: Why must a single bank trust fund, 100 percent of the interest of which is to be sold to a single underlying pension trust fund, register such *single,* lump sale under the 1933 Act even without the Section 3(a)(2) exemption? The Section 3(a)(2) amendment is needed because it refers to the sales of interests in the underlying pension trust fund to the *many* employees who participate in it.

Finally, the addition of the "single or" language followed from a suggestion of the General Counsel of Sperry Rand. Letter of Stannard Dunn, General Counsel, Sperry Rand Corp., Hear-

ings Before the Subcomm. on Comm. and Fin. on H. R. 11995, House Comm. on Interstate and For. Comm., 91st Cong., 1st Sess. at 929-30 (1969). He noted that it was the long time administrative practice of the SEC to exempt by no-action letter from the registration requirements interests in most employee pension funds (*viz.*, those in which an amount in excess of the employer's contributions is not invested in employer securities), meaning the *underlying* pension trust funds and not the collective bank trusts in which some are invested. He thus suggested that such policy be codified following the earlier 1967 suggestion of the SEC.[64] Hearings Before the Subcomm. on Comm. and Fin. on H. R. 14742, House Comm. on Interstate and For. Comm., 90th Cong., 2d Sess. 121 (1968). This suggestion was adopted first by the House and subsequently in conference, and the sale of interests in such employee pension funds was by its enactment exempted from registration under the 1933 Act.[65]

64. The fact that the actual language suggested by Mr. Dunn—the appropriate insertion of the clause "or in any employee's stock bonus, pension, or profit sharing trust"—was not adopted is unimportant since the phrase actually used—the appropriate insertion of the clause "single or"—had the same effect.

65. Two subsequent changes in the language of the proposed amendment to Section 3(a)(2) further reflect the change in focus of the amendment to cover not only interests in collective funds, but also interests in the individual employer's pension fund. Thus, although the conference committee agreed with the House to exempt both single and collective funds, it modified the House provision in one respect. Since that provision exempted interests in all pension funds, it was contrary to the longstanding position of the SEC that non-registration of pension interests did not apply in all situations. Specifically, the SEC requires registration where an amount in excess of the employer's contribution to a pension fund is allocated to the purchase by the fund of securities issued by the employer. In order to conform the exemption to SEC practice, a provision was added in conference excluding the above situation from the exemption.

However, the addition of this exclusion created yet another problem, which was remedied in separate legislation adopted a week after the passage by Congress of the conference bill. As noted, the exclusion applied whenever an amount in excess of the employer's contribution was used to purchase *securities* issued by the employer. Since interests in pension funds are themselves securities, the exclusion might have been interpreted to subject to registration *all pension plans* where any money is contributed to the pension fund *directly*

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Consequently, it was this long standing administrative policy—referred to by Mr. Dunn—which was codified into Section 3(a)(2).[66]

No recourse to a colloquy on the floor of the House is needed to confirm this interpretation of Section 3(a)(2).[67] As noted above, the House Report itself describes this Section:

> "The bill would exempt . . . bank . . . administered *corporate pension plans* from the registration and reporting requirements of the Federal Securities Acts, but it does not exempt them from the antifraud provisions of those acts." 1970 House Report at 10 (emphasis added).

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by employees. In such plans, it could be argued that this money is purchasing securities of the employer—viz., the interests in the pension plan. There is no indication, as petitioners assert, that this second change was meant *only* to deal with employee pension plans maintained by a bank (or insurance company) for its *own* employees. Pet. Br. at 132. Accordingly, Section 3(a)(2) was amended again to make it clear that the term "security issued by the employer" as used in the amendment did not include the securities consisting of the interests in the pension fund. See 116 Cong. Rec. at 40608 (Dec. 9, 1970) for a discussion of this final change.

66. The Conference report thus described this change as follows:

> "The House amendment would have codified a long established administrative practice of the Commission by making it clear that this *exemption [from registration] applied not only to collective trust funds, but also to single trust funds.* The conference agreement follows the House version."

H. Conf. Rep. No. 1631, 91st Cong., 2d Sess. 31 (1971).

67. The colloquy cited by petitioner IBT does not in any event explain Section 3(a)(2) in the fashion petitioner argues. IBT Br. at 126-127. All it does is restate the Section 3(a)(2) exemption for single trust funds and confirm the long standing SEC administrative practice that employee pension plans in which amounts in excess of employer contributions are invested in employer securities must register under the 1933 Act. By confirming the latter codification of the SEC administrative practice referred to by Mr. Dunn, such colloquy in fact supports the interpretation above that the phrase "single . . . trust fund" refers to the underlying pension trust fund and not to some single bank trust fund in which the underlying pension fund may invest.

The language is unambiguous: the corporate pension plans themselves are exempted and not some single bank trust fund in which they may invest.

Consequently, Congressional intent in the securities law area is best seen by looking directly to the federal securities laws and the recent Investment Company Amendments Act of 1970. It will thus be demonstrated below that the language and legislative history of ERISA do not establish a Congressional intent to deny employees investing in pension plans the protection of the antifraud provisions of the federal securities laws. Rather, ERISA was designed to cure a variety of abuses in the pension area which complement the applicability of the federal securities laws. See *SEC* v. *Garfinkle,* CCH Fed. Sec. L. Rep. Para. 95,020 ("the fact that ERISA gives the Secretary of Labor power to regulate welfare funds in no way offsets the SEC's authority over securities transactions . . . the SEC clearly has concurrent, if not exclusive, standing to sue").

F. Blue Sky Law Supports the Characterization of an Interest in the Local 705 Pension Fund as a Security.

That an interest in an employee pension plan is a security finds further support in both the state definition and the Uniform Securities Act.[68] The Illinois Securities Law of 1953 definition of "security" is for our purposes identical to that found in the federal securities laws. Ill. Rev. Stat. Ch. 121½, Section 137.2-1. That it includes interests in employee pension plans is made clear by the exemption of such "securities issued by or pursuant to . . . employee pension trusts or plans" from the registration

68. The relevance of what is considered a "security" under state law to the definition of "security" under the federal securities laws is demonstrated by the approval by the Supreme Court in *SEC* v. *United Benefit Life Ins. Co.,* 387 U. S. 202, 211-212 (1967), of Professor Loss' statement:

> "At the state level the Uniform Securities Act makes explicit what seems to be the view of the great majority of blue sky administrators to the effect that variable annuities are securities." 1 Loss, *Securities Regulation* 499.

requirements. Ill. Rev. Stat. Ch. 121½, Section 137.3-0.[69] A similar definition of "security" and exemption from registration for "any investment contract issued in connection with an employees' . . . pension . . . plan" is found in the Uniform Securities Act.[70] 7 Uniform Laws Ann., Uniform Securities Act §§ 501(1) and 402(a)(11) (1970). Of course, because ERISA specifically saves all state securities laws, the sale of securities by employee pension plans remain subject to the regulation of all state blue sky laws. Section 514(b)(2)(A) of ERISA.

G. An Interest in a Pension Fund Is Analogous to an Interest in a Mutual Fund or a Variable Annuity.

The interest of the plaintiff in the Local 705 Pension Fund is for our purposes analogous to both an interest in a mutual fund and an interest in a variable annuity contract.

As noted above (pp. 12-13), the similarities between an interest in a mutual fund acquired through a periodic investment program and an interest in an employee pension plan have been recognized by the SEC for over 35 years. For example, SEC Commissioner Purcell noted at the *1941 Hearings* that Congress, having recognized the similarity between employee pension plans and ordinary mutual funds, believed interests in such plans to be securities and so provided in enacting the Investment Company Act of 1940:

> In fact, many employee plans are in the nature of investment trusts and are *indistinguishable in legal effect* from investment companies offering securities to the public at large. The Congress in the Investment Company Act of 1940 recognized this fact by providing certain limited exemptions from the provisions of that act for 'employees'

69. The Chamber of Commerce likewise has counted 32 states which "provide an exemption for securities issued in connection with an employee benefit plan." Chamber of Commerce Br. at 14 and n. 15. Clearly, such an exemption would not be needed were such employee pension plan interests not considered to be "securities."

70. The Uniform Securities Act has been adopted in 32 jurisdictions. 7 Uniform Laws. Ann.: Cumulative Annual Pocket Part. at 342 (1976).

securities companies' in section 3 (c) (13) [now Section 3 (c) (11)] and 6(b)." *1941 Hearings* at 895 (emphasis added).

Congress thus defined an "employees' securities company" as one type of "investment company" in Section 2 (a) (13) of the 1940 Act. Consequently, any employee pension plan which falls within that definition is subject to the registration requirements of the 1940 Act unless otherwise excluded or exempted.

Petitioner IBT's discussion on this point is without focus and provides no support for its position. First, both of the SEC rulings cited involved (admitted) "employees' securities companies" (as defined in Section 2(a)(13)) which sought and received exemptions, pursuant to Section 6 (b), from many of the requirements of the 1940 Act. *Electrical Securities Corporation,* [41-44 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 75,227 (1941) (general exemption granted except from Section 30 (a)); *G. E. Employees Securities Corporation,* [41-44 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 75,226 (1941) (exemption granted from provisions applicable to closed-end non-diversified management companies). Second, an "employees' securities company" (as defined in Section 2 (a)(13)) can, indeed, take the form of a "trust." See *General Electric Company—General Electric S & S Program Mutual Fund,* [67-69 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,630 at p. 83,354 (1968) (G. E. S & S Program Mutual Fund is a "trust" which qualifies as an "employees' securities company" for certain exemptions pursuant to Section 6(b)).

Petitioner's attempt to make something of the difference between Sections 3(c)(11) and 6(b), consequently, just does not work. This was recognized in 1941 by the Assistant General Counsel of the SEC:

"Quite apart from the Securities Act of 1933, the Investment Company Act of 1940 also has a bearing upon certain types of employees' pension or profit-sharing plans. Any plan which falls within the definition of an "employees' securities company" under Section 2 (a)(13) of that Act must register unless it is excluded from the definition of the term 'investment company' by Section 3(c)(13) or exempted from registration by an order of the Commission upon application and hearing under Section 6(b)." *1941 Opinion.*

For a practical example, the trust involved in *General Electric S & S Program Mutual Fund, supra,* was not able to take advantage of what the SEC called the "complete exemption" of Section 3(c)(11)—because it was not qualified under Section 401 of the Internal Revenue Code—and thus had to make do with the partial Section 6(b) exemption granted to it. *Id.* at p. 83,355. In either event, the important fact for our purposes is that an employee pension plan is (1) indistinguishable "in legal effect" from a mutual fund, and, in recognition of that similiarity, (2) falls within the definition of a mutual fund and, in certain cases, within the definition of "employees' securities company," unless completely exempted by Section 3(c)(11)—when also a trust qualified under Section 401 of the Internal Revenue Code—or otherwise exempted by Section 6(b).

Both *SEC* v. *Variable Annuity Life Ins. Co.,* 359 U. S. 65 (1959) (*VALIC*), and *SEC* v. *United Benefit Life Ins. Co.,* 387 U. S. 202 (1967), also support the conclusion that an interest in the Local 705 Pension Fund is a security. In *VALIC,* the Court held that variable annuity contracts were securities under the federal securities laws and not insurance policies exempt from registration under Section 3(a)(8) of the 1933 Act. And, in *United Benefit Life,* the Court also held that a flexible fund annuity—in which the annuity holder had a minimum guarantee as well as a participating interest in an investment fund—was a security under the federal securities laws and not exempt under Section 3(a)(8). The securities at issue in both *VALIC* and *United Benefit Life* were investment vehicles designed to provide the buyer with a financial return on retirement. Even though both the annuity contract in *VALIC* contained several elements of conventional life insurance, *VALIC* at 80-81 (Brennan concurring opinion), and the flexible fund

annuity in *United Benefit Life* contained a minimum insurance type guarantee, *United Benefit Life* at 205-208, the Court construed them as "securities" because of their similarity to a mutual fund. As such, the detailed disclosures required by the 1933 Act (and the 1940 Act) were needed to provide the annuity buyer with protection from fraud. *VALIC* at 76-77, 85; *United Benefit Life Ins.* at 212.

In a similar fashion, an investment in the Local 705 Pension Fund is an investment vehicle designed to provide the buyer with a financial return on his retirement akin to a mutual fund or variable annuity. First, the fact is clear that the investment performance of an employee pension plan does, indeed, affect the economic return to a participant on his retirement. See pp. 10-11 and 59-60, *supra*. Second, and particularly with respect to the Teamster pension funds, the risk of loss is substantial. See pp. 59-60, *supra*. Third, as in *United Benefit Life,* the "advertisements" of the Local 705 Pension Fund "appeal[ed] to the purchaser not on the usual . . . basis of stability and security but on the prospect of 'growth' and sound investment management." *Id.* at 211 and n. 15. See pp. 11 and 60, *supra.*

Just as the Court in *VALIC* and *United Benefit Life* separated the conventional life insurance attributes from the security involved, so is the employment relationship entered into by plaintiff here separate from the security he has purchased. There is no reason why plaintiff cannot be both an investor and an employee. See pp. 45-46, *supra.* Indeed, other courts have found no problem with this. *Collins* v. *Rukin,* 342 F. Supp. 1282 (D. Mass. 1972); *SEC* v. *Addison,* 194 F. Supp. 709 (N. D. Tex. 1961). Thus, the court in *SEC* v. *Koscot Interplanetary, Inc.,* 497 F. 2d 473, 476 (5th Cir. 1974), separated the marketing of cosmetics aspect from the recruiting aspect of the pyramid sales scheme there at issue, commenting "case law countenanced the fragmented approach." And, certainly, those employees who invest in employee pension plans which concededly involve securities subject to the 1933 Act registration requirements are both employees and investors.

Finally, in *VALIC* and *United Benefit Life Ins.,* the fact that the issuers were subject to stringent state insurance company regulations did not fill the need for full and fair disclosure as required under the federal securities laws:

> "The emphasis is on disclosure: the philosophy of the Act is that full disclosure of the details of the enterprise in which the investor is to put his money should be made so that he can intelligently appraise the risks involved.
>
> The regulation of life insurance and annuities by the States proceeded, and still proceeds, on entirely different principles. It seems as paternalistic as the Securities Act of 1933 was keyed to free, informed choice. Prescribed contract clauses are ordained legislatively or administratively. Solvency and the adequacy of reserves to meet the company's obligations are supervised by the establishment of permissible categories of investments and through official examination . . . In this sort of operation, examination by state insurance officials to determine the adequacy of reserves and solvency becomes less and less meaningful."

VALIC at 77 and 85 (Brennan concurring opinion).

In similar fashion here, the existence of ERISA does not preempt the need for a truthful statement of all material risks attendant to an investment in the Local 705 Pension Fund prior to the investment decision.

H. An Investment in the Local 705 Pension Fund Is Also a "Certificate of Interest in or Participation in a Profit Sharing Agreement."

The plaintiff's investment in the Local 705 Pension Fund is also a "certificate of interest in or participation in a profit sharing agreement" and, as such, is included within the definition of "security" under the federal securities laws. This has been recognized by the SEC since 1941:

> "you are correct in surmising it to be our position that the security which is involved within the meaning of Section 2(1) of that Act in connection with the offer or sale of interests in certain types of [employee pension] plans . . . frequently . . . may come . . . within the phrase 'certificate

of interest or participation in a profit sharing agreement.'" *1941 Opinion.*

Thus, Daniel holds an interest or participation in the Local 705 Pension Fund. This Fund is managed by the Local 705 Pension Fund trustees with a view to making a profit and paying out such profits, along with the initial investments, to retiring Local 705 union members in the form of retirement benefits. In other words, disregarding form for substance, and with an "emphasis on economic reality," *Tcherepnin, supra,* at 336, the Local 705 Pension Fund is a "profit sharing agreement" because those investors who hold an interest therein share the profits made. *SEC* v. *Wickham,* 12 F. Supp. 245, 249 (D. Minn. 1935); *SEC* v. *Addison,* 194 F. Supp. 109, 721-22 (D. Tex. 1961). That the particular sharing formula depends upon a variety of factors, including vesting requirements, does not destroy this conclusion. There is no requirement that the sharing be done on a per capita or pro rata basis. Neither is there any requirement that the "participation" in the profit sharing agreement be evidenced in writing by a written certificate or otherwise. See p. 33, *supra.*

I. The Security in the Local 705 Pension Fund Was Acquired by Plaintiff in a "Sale".

1. The Statutory Definitions.

The term "sale" has been defined in Section 2(3) of the 1933 Act to include:

> *"Every* . . . disposition of a security or interest in a security for value." (Emphasis added).

And, the term "sale" has been defined in Section 3(a)(14) of the 1934 Act to include:

> "Any contract to sell *or otherwise dispose of."* (Emphasis added).

Whether there is a "sale" of a security in the Local 705 Pension Fund *for purposes of the 1934 Act* thus depends on whether

there has been a sale *or other* disposition of such security. Contrary to petitioners' assertions, the plaintiff has acquired some sort of an interest in the Local 705 Pension Fund. And, as shown above, even though an undivided interest not evidenced by a certificate, that interest is a security. Consequently, whether by gift, purchase, or otherwise, there has been a *disposition* of this security in the Local 705 Pension Fund to the plaintiff. The *unambiguous* definition of "sale" in the 1934 Act has thus been satisfied.[71]

This is particularly so because policy considerations, as well as economic reality, compel the importance of a "non-restrictive" approach to the definition of "sale." Employee pension plans have become so large that they now play an integral role in the financial well being of tens of millions of Americans. Petitioners' argument that no investment decision is present is thus wrong. As noted above, there is simply no reason why an employee cannot also be an investor. See pp. 33-34 and 45-46, *supra;* see also *1941 Opinion* at p. 75,387 (calling such a person an "employee-investor"). Further, petitioners are again wrong when they assert that an employee pension plan is of no importance to an employee in his investment decision-making. This assertion just does not make any common sense and the studies show it.

2. Plaintiff Has Acquired His Security in the Local 705 Pension Fund in a Disposition for Value.

Whether there is a "sale" of the security in the Local 705 Pension Fund for purposes of *the 1933 Act* depends on whether

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71. The court in *International Controls Corp.* v. *Vesco,* 490 F. 2d 1334 (2d Cir.), *cert. den.* 417 U. S. 932 (1974), has thus held that a dividend consisting of stock in a corporate spin-off was a "sale" of the stock even though the receiving shareholders had no control over the issuance of the dividend and gave *no consideration* for it. The court reasoned (*Id.* at 1345):

> "[I]t is a transaction involving, as it unquestionably does, the disposition of securities and, therefore, one for which the corporation is well deserving of and entitled to the protection of § 10(b)."

there has been a (1) disposition of such security (2) for value. Clearly, as shown above, there is no question but that the first element of this definition is present here. If this disposition has been for "value", then the second element of the definition of sale in the 1933 Act will also be present. That value has been given, however, is just as clear as the presence of a disposition. There is no requirement that the value element can be satisfied only by a cash payment or by the delivery of property. Here, the value element is satisfied by the plaintiff's giving of services, or, alternatively, by the contribution on behalf of the plaintiff of a portion of his economic compensation.

As discussed above (see pp. 51-57) the giving of services constitutes value and adequate consideration for an investment in the Local 705 Pension Fund.[72] Indeed, given the vast amounts paid by employees or on their behalf into employee pension plans—now estimated to exceed $150 billion—the only responsible view is that such monies are invested in return for value given by the employee in the form of services rendered. While this is true for a corporate pension plan voluntarily established by an employer without bargaining, it is even more so for those multi-employer union pension plans which are the product of collective bargaining.

Equally important, both Congress and the courts have adopted the view that employer payments to employee pension plans constitute a part of the wage structure. See pp. 52-56, *supra*. The consideration here given by the plaintiff for the acquisition of a security in the Local 705 Pension Fund thus includes not only the services he has rendered but also, by another view, a portion of the wages he has received.

The conclusion that the giving of services in exchange, in part, for the security involved constitutes "value" is not affected by the petitioners' characterization of the Local 705 Pension Fund

72. Most courts find adequate consideration in the fact of continued employment, without a showing that the employee would not have remained at his job in the absence of the pension plan. Note, Problems of Private Pension Plans, 70 *Harv. L. Rev.* 490, 494 (1957).

as "non-contributory".[73] To call a pension plan non-contributory is a misnomer if it is also to mean that members of the plan do not give value in exchange for their acquisition of securities in the plan. The Congress, the courts, and commentators have uniformly recognized that:

> Regardless of the form they take, the employers' share of the costs of these plans or the benefits the employers provide are a form of compensation.

S. Rep. No. 1440, 85th Cong., 2d Sess. at 4 (1958). See, *e.g.*, Hearings Before the Special Subcomm. on Labor of the House Comm. on Ed. & Labor, 87th Cong., 1st Sess. at 27 (1961) (Secretary of Labor Goldberg) (pension element is part of "wage settlement"); See *Lewis* v. *Benedict Coal Co.*, 361 U. S. 459 (1960); *Los Angeles Department of Water and Power* v. *Mannhart*, 46 U. S. L. W. 4347 (April 25, 1978); *Allied Structural Steel Co.* v. *Spannaus*, 46 U. S. L. W. 4887 (June 28, 1978); *Inland Steel* v. *NLRB*, 77 NLRB 1 (1948), enf. granted 170 F. 2d 247 (7th Cir. 1948), *cert. den.* 336 U. S. 960 (1949). Petitioners are thus a generation out of date in their attempt to apply the "gold watch theory"[74] of employee pension plans to the federal securities laws. IBT Br. at 62.

These bargained for employer contributions on behalf of the Local 705 union members thus represent a substantial economic portion of their wages received in consideration of services performed. From the employer's point of view, the pension fund payments constitute part of the employee's compensation package: whether paid as wages or pension contributions, both are

73. "The reality of the situation is that the employee contributes the fruits of his labor, regardless of the form of contribution. All benefit plans are compensation for employment; therefore all plans are contributory. Likewise, all employment choice is voluntary; therefore all plans are voluntary." Note, Employee Compensation Plans: The Need for Stricter Regulation, 6 *St. Mary's L. J.* 192, 204 (1974).

74. This is Senator Javits' description of the now discredited "gift theory" of employee pension plans. Address by Senator Jacob K. Javits, Briefing Conference on Pensions and Employee Benefits (Sept. 19, 1974).

cash outlays, tax deductible to the employer. However, as part of an employee's compensation, such payments constitute the employee's giving of value for his security in the Local 705 Pension Fund.

The fact that the dollars invested go directly from the employer into the Local 705 Pension Fund, of course, makes no difference. This is merely a reflection of certain tax provisions designed to encourage the adoption of employee pension plans. See p. 4 n. 5, *supra*. For example, that payment of value can be indirect is confirmed in *SEC* v. *Harwyn Ind. Corp.*, 326 F. Supp. 943 (S. D. N. Y. 1971). There, securities in a subsidiary were spun off by the parent corporation to the parent corporation shareholders without direct payment by the shareholders. In holding that the parent corporation shareholders acquired the securities of the subsidiary for value, meeting the definition of sale under the 1933 Act, the Court stated:

> "We see no reason to construe §§ 2(3) and 5 as requiring that the 'value' requiring registration must flow from the immediate parties who received the stock [of the subsidiary] . . ."

Id. at 954. Thus, value flowed there *not* directly from those who acquired the securities involved (the parent corporation shareholders) but was inherent in the parent's prior transfer of assets to the subsidiary. Here, the source of the value given is the employee even though the form of payment may be indirect. The important point is that in both *Harwyn* and here value is given in return for the disposition of a security. In *Harwyn*, a third party payment satisfies the "value" requirement. Here, whether from the employee indirectly or from the employer directly, value is clearly given for the disposition of a security in the Local 705 Pension Fund.[75]

75. Cf. *Hector* v. *Wiens*, 533 F. 2d 429, 431-433 (9th Cir. 1976) (investor in a cattle feedlot investment contract scheme gave his promissory note to a bank and the bank gave money to the feedlot); *International Controls Corp.* v. *Vesco*, 490 F. 2d 1334 (2d Cir. 1974).

In any event, there is no conceptual distinction between the instant facts and the situation wherein the employee first receives as part of his wages the employer contribution in cash and then pays over such cash into the pension fund. See p. 46, *supra*. In both cases, value is given and a security is received. In fact, the employees must vote on the union negotiated package dividing employee compensation between cash wages, pension investments, and other benefits. Surely, few, if any, Local 705 members would vote for a labor contract which provides for employer contributions to a pension fund in lieu of additional wages if they knew they had a minimal chance of ever receiving back any retirement benefit, or if they knew their investments would be poorly managed.

In fact, the presence of value given in this situation has been affirmed by judicial interpretation. Thus, in *Collins* v. *Rukin*, 342 F. Supp. 1282 (D. Mass. 1972), an employee brought a claim under the antifraud provisions of the federal securities laws against his employer in connection with certain incentive stock options issued to the employee. There, the defendants argued, as petitioners do here, that the antifraud rules should not apply to a security which is "incident to and part and parcel of an employment contract for personal services," and that "certainly, Section 10 of the 1934 Act and Rule 10b-5 promulgated . . . thereunder were not intended to create a federal right for alleged misrepresentations in private employment negotiations." *Id.* at 1286-87. In response the Court stated (at 1287-88):

> "No compelling reason has been suggested to this Court why one who, in the interest of promoting his company and employing the most talented people in a particular field, engaged in fraudulent practices in connection with the offer or sale of securities should enjoy any greater freedom from the operation of the federal securities laws than one who perpetrates a fraud without promotional or employment motive."

Further, in response to the defendants' argument that no "sale" was involved because of the employment context, the court noting that (at 1289):

> "the broad design of the federal securities laws should not be frustrated by restrictive application of the purchase-sale requirement . . . [and that] the wording of each definitional section warrants non-restrictive interpretation of the concept of sale . . ."

held that

> "plaintiff's performance of service satisfies the 'value' requirement of a sale of securities." *Id.*[76]

Similarly, the court in *SEC* v. *Addison,* 194 F. Supp. 709, 722 (N. D. Tex. 1961) said

> "The giving of personal loan notes, evidences of indebtedness, certificates of interest or participation in profit-sharing agreements and investment contracts whether as a gift out of gratitude for, or in consideration or exchange of, the personal loans of money *or services of labor rendered,* constitute sales of securities because either way it amounts to a disposition or giving of a security for value." (Emphasis added).

Accord, *Lawrence* v. *SEC,* 398 F. 2d 276 (1st Cir. 1968); *cf. Vine* v. *Beneficial Finance Co.,* 374 F. 2d 627, 634 (2d Cir. 1967). Further judicial support is found in the cases under Section 16(b) of the 1934 Act which hold that securities issued to an employee for services under an employment contract are acquired in a purchase. See *Truncale* v. *Blumberg,* 88 F. Supp. 677 (S. D. N. Y. 1950).

The conclusion that value is given here has also received support from recent SEC interpretation. For example, in *Oklahoma National Gas Co.,* [71-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,583 (1971), the employer established an Executive Incentive Compensation Plan whereby certain em-

76. See *Spector* v. *L. D. Motor Inns, Inc.,* CCH Fed. Sec. L. Rep. ¶ 95,261 at 98,346 (5th Cir. 1975) ("The 'purchase or sale' referred to . . . are not limited to technical common law sales").

ployees would receive, if a vesting requirement were met, certain deferred benefits, all in exchange for no consideration other than continuing to work for the employer for the duration of the Plan. There, the Commission refused to issue a no-action letter because it considered that "value will pass to ONG [the employer] in the sense that Participants will be induced to continue their employment with ONG from which ONG will derive substantial benefits." *Id.* at 81,252. Similarly, the SEC refused to issue a no-action letter because of the presence of value, and hence a sale, through the continuing performance of services in a matter involving a stock bonus plan for employee inventors, *Allis-Chalmers Corp.,* [72-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,803, a matter involving the disposition of employer securities to high performing salesmen, *Keene Corp.,* [71-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,475, and a matter involving an executive bonus plan, *Missouri Research Laboratories, Inc.,* [72-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,036. *Cf. Girard Trust Bank,* [71-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,547.

Petitioners' citations to allegedly contrary SEC interpretations are inapposite because they were made in the context of whether all such pension plan interests have to be registered under the 1933 Act.[77] As made clear by both the assistant general counsel of the SEC in the *1941 Opinion* and by Commissioner Purcell in the *1941 Hearings,* compulsory and noncontributory employee pension plans do not have to register

77. The court in *Harwyn,* 326 F. Supp. at 953-54, has thus rejected the same sort of argument petitioners assert here:

> "Defendants take the position that a long-standing loophole in the 1933 Act had been recognized by the Commission and relied upon by counsel as permitting spin-offs of the type here involved to be made without registration. . . . Feeding upon itself the view became accepted as a 'loophole' that could be closed only by Congress. . . . [However,] to stop the abuse of what had theretofore been . . . a relatively harmless crack in the integrated structure of the securities laws . . . [and] in interpreting the statute we must look to its overall purpose, which is to provide adequate disclosure to members of the investing public, rather than engage in strangulating literalism."

under the 1933 Act because for purposes of the registration requirements such plans do not involve a sale.[78] See pp. 64-69, *supra*. As such, this no-sale theory was part and parcel of old Rule 133 and was *only* applied in the context of the registration requirements. Finally, as noted below (see pp. 99-104), petitioners' citations to the legislative history of the Welfare and Pension Plans Disclosure Act and to ERISA are inapposite because they were made in the context of the substantive regulatory legislation then under discussion—and not in the context of the far different types of obligations imposed by the antifraud rules of the securities laws.

3. There Is No "Volitional" Requirement to the Definition of Sale.

The presence of both elements of the definition of "sale" under the 1933 Act should end the inquiry. However, petitioners argue further that because the contribution is "compulsory" there can be no sale—despite the categorical language of the statute that "*every* disposition of a security . . . for value" is a sale. This attempted artful dodge is what Judge Wisdom has cautioned against: "The securities laws are intended to protect investors, not merely to test the ingenuity of sophisticated corporate counsel." *Smallwood* v. *Pearl Brewing Co.*, 489 F. 2d 579, 592 (5th Cir. 1974).

78. The second *1941 Opinion* thus states:

> "No 'offer' or 'sale' is involved in the case of a noncontributory plan, where the employees are not requested to make contributions, or in the case of a compulsory plan, where there is no element of volition on the part of employees whether or not to participate and make contributions. Thus, there are both the presence of a 'security' and the presence of a 'sale' *in those cases in which the Commission considers that registration of interests in employees' plans is required.*" (Emphasis added).

There is no "volitional" element contained in the definition of sale in the federal securities laws. The words "dispose" and "disposition" are not modified by the adjective "voluntary." Indeed, the recent Supreme Court decision in *Ernst and Ernst* v. *Hochfelder*, 47 L. Ed. 668, 679 (1976) underscores the importance of this statutory language.[79] However, even if required, "volition" is present here in that every Local 705 member has the option of not working for his present employer and thereby not purchasing the security. See n. 73, *supra*. Thus, the Affidavit of plaintiff makes it clear that he would not have worked for a Local 705 covered employer had full and fair disclosure been made with respect to the Local 705 Pension Fund. Daniel Affidavit Para. 7.

Volition is also present in the individual voluntary act of each Local 705 member exercising his vote as to whether to accept or reject the labor contract which sets out the required employer contribution. The inescapable fact is that an employee pension plan is an important determinate in an employee's employment decision.[80] This is especially true in light of the extent of job mobility in the country today.[81] It is thus likely that an employee

79. See *Blue Chip Stamps, supra,* at 756 ("The starting point in every case involving construction of a statute is the language itself") (J. Powell concurring).

80. For example, then Secretary of Labor Arthur Goldberg has testified:

> "It is commonplace today when you go into a firm for employment that one of the things you discuss is what type of welfare and pension plan an employer has. That is an essential condition of employment as any employer, I am sure, would tell you testifying before you."

Hearings Before the Special Subcomm. on Labor, House Comm. on Ed. and Labor, 87th Cong., 1st Sess. at 32 (1961); See S. Rep. No. 1734, Welfare and Pension Plan Investigation, 84th Cong., 2d Sess. 11-13 (1956); Hearings Before the Subcomm. on Labor, S. Comm. on Labor and Public Welfare, 92nd Cong., 2d Sess. 99 (1972) (then Secretary of Labor Hodgson) ("Indeed, the variety of pension plan types is a significant element in the competition among employers for the workforce").

81. The Bureau of Labor Statistics has, for example, found that in a period of one year, ten percent of the labor force shifted from

(Footnote continued on next page)

will be faced with a number of employment decisions in his lifetime and, as he gets older, such shifts will be more and more affected by the pension plan offered by his employer. Accordingly, an employee will be faced with a meaningful decision, even in the case of a compulsory plan, whether to acquire an interest in a pension fund. And, this voluntary decision is sufficient to satisfy the "sale" requirement under the antifraud provisions of the securities laws.

Finally, diluted from the *1941 Opinion*, the volition argument is part and parcel of the now rescinded Rule 133. 17 C. F. R. Section 230.133 (1964). Rule 133 provided that, if a merger were authorized by an appropriate majority vote binding on all shareholders, there would be "no sale" of a security exchanged for a new security in a merger because of the lack of a volitional element. Even while applicable, however, Rule 133 was interpreted by both the SEC and the courts to bar the existence of a sale because of its compulsory nature *only* for purposes of the registration requirement, and *not* to deny the existence of a sale for purposes of the antifraud provisions. Sec. Act. Release No. 3420 (1951).

This Court in *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1959), has, for example, impliedly rejected the "volition argument." There, the Court held that a corporate merger involved a "sale" for purposes of the antifraud rules, notwithstanding the existence of Rule 133 providing that "no-sale" was involved for the purposes of the registration requirements. See, *e.g.*, *Exchange National Bank of Chicago* v. *Touche Ross and Co.*, [76-77] CCH Fed. Sec. L. Rep. ¶ 95,614 at p. 90,064 (2d Cir. 1976) ("The purposes of the registration and antifraud provisions differ . . ."). This Court has thus recognized the appropriateness of treating a transaction as a sale for purposes of the antifraud rules, but not for purposes of the registration

(Footnote continued from preceding page.)
one job to another. See Hearings Before the Subcomm. on Labor, S. Comm. on Labor and Public Welfare, 90th Cong., 2d Sess. 249-254 (1968).

requirements.[82] Petitioners thus misread *National Securities.* Whether a *dissenting* shareholder in *National Securities* ultimately agrees to exchange his shares in the merger or seek an appraisal remedy, a "sale" still exists over his objections—albeit compulsory. In fact, many cases have held that under the antifraud rules a "sale" may occur in a variety of situations where there is no "voluntary" action by the alleged purchaser. See, *e.g.*, *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262, 267 (7th Cir. 1967); *Vine* v. *Beneficial Finance Co.*, 374 F. 2d 627, 635 (2d Cir. 1967); and *Voege* v. *Amer. Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965); *Coffee* v. *Permian Corp.*, 434 F. 2d 383 (5th Cir. 1960).

Rule 133 was in any event roundly criticized, 1 Loss, *supra*, 528-534, and rescinded in 1972. Sec. Act. Release No. 5246 (1972); 17 C. F. R. 230.145 (1973). In rescinding Rule 133 the SEC rejected the compulsory, lack of volition argument:

> "The Commission is of the view that the "no-sale" approach embodied in Rule 133 overlooks the substance of the transactions specified therein . . . The fact that such relationships [between stockholders and a corporation] are in part controlled by statutory provisions of the state of incorporation does not preclude as a matter of law the application of the broad concepts of "sale", "offer", "offer to sell", and "offer for sale" in Section 2(3) of the Act which are broader than the commercial or common law meanings of such terms.
>
> The basis on which the "no-sale" theory is predicated, . . . in the Commission's opinion, is at best only correct in a formalistic sense and overlooks the reality of the transaction.
>
> The corporate action . . . is derived from the individual consent given by each shareholder in voting on a proposal to merge . . . The corporate action . . ., therefore, is not some type of independent fiat but is only the aggregate effect of the voluntary decisions made by the individual stockholders to accept or reject the exchange." *Id.* at 2.

82. It is certainly no new idea that "the same words may have different meanings in different parts of the same act . . ." *Lamar* v. *United States*, 240 U. S. 60, 65 (1916) (Holmes, J.).

The same reasoning of the SEC can be applied to reject the application of the "no sale" theory to the instant case where the pension fund is a product of collective bargaining. The collective bargaining agreement between an employer and his employees is negotiated by Local 705. The resulting labor contract will allocate a certain portion of employee compensation to employer pension fund contributions (and other benefits) and the balance to cash wages. This labor contract will then be presented to the Local 705 union members for their vote. A volitional element is thus present when the Local 705 members vote to ratify or reject the labor contract encompassing such Local 705 Pension Fund investments. The effect is the same as a shareholder vote on a merger proposal.[83] The fact that a merger plan or a labor contract will contain a myriad of other features does not detract from the presence of a volitional element with respect to the exchange of value. The Local 705 Pension Fund contributions are not some type of independent employer "fiat" but the aggregate effect of the voluntary decisions of the union members. Petitioners' focus on the lack of a volitional element is as stale as old Rule 133.

II.

ERISA DOES NOT IMMUNIZE PETITIONERS FROM LIABILITY UNDER THE ANTIFRAUD RULES OF THE FEDERAL SECURITIES LAWS.

Petitioners embrace the recently repealed Welfare and Pension Plans Disclosure Act of 1958 (the "WPPDA") and the recently enacted ERISA as witness to Congressional intent to shield employee pension plans from the antifraud rules of the federal securities laws. This recourse to the federal labor laws as a shield from liability, in fact, evidences the weakness of petitioners' arguments here. Congressional intent in the securities law area is best seen by looking directly to the federal securities laws, including the recent Investment Companies Amendments Act of 1970. Petitioners' argument is thus an empty embrace.[84]

83. For the same reasons set out in the discussion on *National Securities, supra,* the presence under certain conditions of an appraisal remedy for a dissenting shareholder in some jurisdictions is irrelevant to the conclusion set out in the text. In any event, an appraisal remedy for the dissenting shareholder on a merger vote is directly analogous to the option of leaving employment for a dissenting employee on a ratification vote.

A. ERISA Is Irrelevant to a Pre-ERISA Securities Fraud Case.

Petitioners place their primary reliance on ERISA as a shield from liability for their intentional securities fraud. This reliance is completely misplaced. There is no conflict between ERISA and the decision below because this case involves a pre-ERISA securities fraud. The plaintiff invested in the Local 705 Pension Fund on the fraudulent inducement of defendants over the period from April, 1955, through November, 1973. In contrast ERISA was enacted on September 2, 1974, and its provisions only take effect prospectively. ERISA Sections 111, 211, and 414; See, *e.g.*, ERISA Section 203(b)(1)(F).

Furthermore, and of equal importance, Daniel would have *no remedy under ERISA* even were ERISA to apply retroactively. This has been expressly recognized by the petitioners below.[85] ERISA has no provisions prohibiting the making of false or misleading representations to induce an employee to invest in a pension fund. Indeed, neither does ERISA have any general antifraud provision of the sort found in the federal securities laws. Consequently, to apply ERISA retroactively and to allow ERISA to preempt the antifraud provisions of the federal securities laws—also retroactively—would be to deny Daniel any relief whatsoever. This Congress did not intend.

84. That even petitioner IBT considers this to be an empty embrace is evidenced by IBT's own *concession* that ERISA does not exempt "employee pension plans from the Federal Securities Laws, either expressly or by implied repeal." IBT Supp. Memo. In Support of Its Motion to Dismiss at p. 4 (filed Oct. 9, 1975).

85. Counsel for petitioner IBT thus stated on oral argument below:

> "We agree, if agreement be needed, that Mr. Daniel . . . has no remedy under ERISA." Transcript, p. 41.

B. Both the Language and Legislative History of ERISA Indicate Continued Applicability of the Antifraud Rules of the Federal Securities Laws.

There is nothing in the language of ERISA or in the WPPDA[86] to support the conclusion that ERISA was intended to pre-empt the antifraud rules of the federal securities laws. *To the contrary,* Section 514(d) of ERISA specifically repeals only the WPPDA (and certain provisions of Title 5 of the U. S. Code relating to administrative procedure) and *specifically saves* all other federal legislation:

> "Nothing in [ERISA] . . . shall be construed to alter, amend, modify, impair, or supersede, any law of the United States . . . or any rule or regulation issued under any such law."

86. Repealed by ERISA, the WPPDA is immaterial to an allegation of securities fraud from 1955 to the date of filing of plaintiff's Complaint. First, the WPPDA has a "savings" provision providing for the continued application of all other relevant legislation. 29 U. S. C. Section 309(b). Thus, this Court has recently held that the WPPDA did *not* pre-empt a state law substantively regulating employee pension plans. *Malone* v. *White Motor Corp.*, ... U. S. ...., 98 S. Ct. 1185 (1978). Second, the WPPDA is part and parcel of a comprehensive set of federal labor laws. Designed to protect against a myriad of abuses which could undermine the national commitment to collective bargaining, it includes substantive regulatory provisions such as certain bonding requirements and prohibitions against theft, embezzlement, bribery, and kickbacks, as well as certain disclosure obligations. These disclosure obligations, however, are more limited than those protections established by the federal securities laws. For example, the WPPDA sets out those specific matters which must be made part of the public record. Accordingly, disclosure under the WPPDA is limited to these matters even though other matters may be as materially important or more so. Finally, the WPPDA did not work. Thus, disclosure under the WPPDA was not accessible to the employee-investor, the person most concerned with such matters. The annual reports and plan descriptions which were prepared were "published" only by filing with the Secretary of Labor, by holding copies in office files and the principal office of the plan, and by mailing only upon written request certain summary information to a plan participant. Section 307. The burden was thus on the participant to uncover any frauds against him. *Mundheim and Henderson* at 818. It is thus not surprising that the WPPDA was not very successful. S. Rep. No. 93-127 in 3 *U. S. Code Cong. and Admin. News* 4841 (1974).

Indeed, this savings provision takes on additional light here when read against the recent 1970 Act—in which Congress expressly recognized interests in employee pension plans to be securities and exempted most of such plans from the registration requirements.

In addition, not only does ERISA not pre-empt the federal securities laws, it also does not pre-empt state securities laws. The ERISA provisions pre-empting all state laws relating to employee benefit plans expressly do not pre-empt state securities laws relating to employee benefit plans. Section 514(b)(2)(A) thus states:

> "Nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates . . . securities."

This state savings provision also takes on additional light when it is recognized that interests in employee pension plans are considered to be securities under most state blue sky laws. See pp. 78-79, *supra*.

Not only the express language of ERISA (and the WPPDA), but also the legislative history of ERISA and the WPPDA supports the conclusion that they were not designed to pre-empt the federal securities laws. For example, the legislative history of the WPPDA cited by petitioners does not indicate that either Congress or the SEC considered interests in employee pension plans outside the scope of the antifraud rules. Rather, the focus of this legislative history was on the legislation then variously pending before Congress, providing for, among other things, the detailed and complex substantive regulation of pension funds through the prescribing of duties and responsibilities in their day-to-day operations, the filing of disclosure documents with a government agency, and the adopting by such agency of detailed rules and regulations. See, *e.g.*, Welfare and Pension Plans Investigation, S. Rep. No. 1734, 84th Cong., 2d Sess.

at 8-10 (1956).[87] And, the comments of the SEC were directed to the fact that, except for certain pension plans involving the purchase of employer securities, SEC administrative policy was to exempt all such plans from the registration requirements. See, *e.g.*, Hearings Before the Senate Subcomm. on Welfare and Pension Funds of the Comm. on Labor and Public Welfare, 84th Cong., 1st Sess. at 944 (1955).

This focus on the substantive regulation of employee pension plans is made most clear by the role envisaged in this regulatory scheme by the SEC. Initially, the SEC had prepared a detailed plan based on the expectation that 175,000 plans would be subject to *registration* and that between 30,000 and 40,000 plans would be subject to *annual reporting* requirements—all on an estimated budget of $1,325,000. Hearings Before the Senate Subcomm. on Welfare and Pension Plans Legis., Comm. on Labor and Public Welfare, 85th Cong., 1st Sess. at 62-70 (1957). However, Senators Kennedy and Ives subsequently indicated that the scope of the proposed legislation would be much greater—involving registration and reporting of up to 300,000 plans. *Id.* at 107 *et seq.* And, they asked the SEC to prepare a new plan giving cost estimates for processing up to 500,000 pension plans. *Id.* at 118. This new SEC report (*Id.* at 119-124) projected costs up to $3,125,000 and concluded:

> "The magnitude of the task imposed by this legislation would tend to overshadow the Commission's present work." *Id.* at 119.

Obviously, the federal securities laws do not in this fashion substantively regulate employee pension plans—and the SEC has indicated this. However, this legislative history in no way in-

87. Interestingly, this Report also noted (at 3):

> "These employer-employee plans, whether or not collectively bargained, or whether contributed to solely by management, or on a joint management-employee basis, actually, and under existing law, proceed on the basis that the contributions to them by management *are in the nature of employees' compensation for employment* or, stated in another way, * * * that the cost of an employee's service is greater than the amount currently paid him as wages. * * *" (Emphasis added).

dicates that Congress or the SEC considered interests in pension funds not subject to the antifraud rules.

The legislative history of ERISA confirms this. It makes plain the Congressional understanding that interests in employee pension plans are "securties"—in most cases exempt from registration under the 1933 Act. For example, the summary of pension related legislation prepared for the *Senate Pension Study* notes that in some cases an employee pension plan may have to register under the 1933 Act and comply with the reporting requirements under the 1934 Act. *Senate Pension Study* at 96. In addition, the *Senate Pension Study* explicitly recognizes that "private pension plans generally fall under the definition of investment companies under the Investment Company Act of 1940," and must register under the 1940 Act unless otherwise exempted. *Id.* Certainly, the conceded applicability of the federal securities laws to certain employee pension plans removes any doubt from the conclusion that ERISA does not pre-empt such securities laws.

Four months after the issuance of the *Senate Pension Study*, the Senate Labor Subcommittee heard testimony from the former Chairman of the SEC, Manuel F. Cohen, who stated:

> "Interests in a private pension plan fall within the definition of a security under the Securities Act of 1933."

1972 Hearings at 231. Chairman Cohen also referred in the *1972 Hearings* to the *Institutional Investor Study* which reached the same conclusion. See pp. 35 *et seq., supra.* Furthermore, although his testimony was necessarily directed at the specific participation, vesting, funding and enforcement provisions of the then pending bill (S. 3598), former Chairman Cohen indicated in response to a question from Sen. Williams, Chairman of the Senate Labor Subcommittee, that the bill "and additional authority and responsibility vested in the Commission" would be necessary for the protection of investors, employers, and the securities market. *1972 Hearings* at 239.

The bill which eventually became ERISA was initiated by Senator Jacob Javits' administrative assistant who had been

counsel for the Studebaker Company when its South Bend, Indiana, plant closed—leaving most of the 8,500 employees without pensions or with reduced pensions. To prevent similar tragedies in the future, he drafted legislation based on minimum standards that had recently been adopted in Canada. Most of the debate on ERISA thus focused on the costs of imposing minimum participation, vesting, and funding standards and of establishing a pension insurance scheme. And, it is this type of substantive minimum standard which makes up ERISA as enacted. However, even these minimum standards do not fully protect employees who are misled into investing into overly risky employee pension plans.

As the replacement for the WPPDA, ERISA is designed better to guard against the type of substantive abuses the WPPDA focused on. ERISA thus contains, for example, specific provisions regulating the funding of employee benefit plans, establishing a plan termination insurance program, and outlining a voluntary program for the portability of vested pension benefits. As such, ERISA is designed to cure a variety of abuses in the pension area, including primarily those dealing with the ongoing administration of employee pension funds. However, ERISA does not mandate full and fair disclosure to an employee prior to his making an investment in an employee pension plan. ERISA *does not regulate the circumstances of entry* into an employee pension plan. Instead, ERISA mandates minimum standards relating to the *operation* of an employee pension plan.

Much of the ERISA legislative history cited by petitioners correctly notes and builds upon the fact that many if not most employee pension plans need not register with the SEC pursuant to the 1933 Act. That this follows Congressional intent is made clear from the Investment Companies Amendments Act of 1970 and the House Report on this legislation. See pp. 72-78, *supra*. As such, the SEC cannot be said to regulate employee pension plans to the extent that they need not register under the 1933 Act. Petitioners' misreading of the ERISA legislative

history and of the SEC role in that history has thus recently been confirmed by SEC Chairman Williams.[88] There is nothing in the legislative history of ERISA to indicate that the antifraud rules of the federal securities laws do not continue to apply.

In fact, only when both ERISA and the antifraud rules of the federal securities laws apply to employee pension plans does the regulatory pattern make good common sense. ERISA deals primarily with the substantive regulation and administration of employee pension plans, while the 1933 and 1934 Acts mandate full and fair disclosure of all material facts prior to the making of an investment decision. In an analogous fashion, the Investment Company Act of 1940 provides for the substantive regulation and administration of mutual funds—while the sale of mutual fund securities still must comply with the disclosure rules of the 1933 and 1934 Acts. In further like fashion, although banks are subject to extensive state and federal substantive regulation, bank securities are still securities subject to the antifraud rules, even though exempt from registration *Tcherepnin* v. *Knight*, 389 U. S. 332 (1967). The substantive regulation of an industry by one statute (viz., ERISA) together with the regulation of the sale of securities by issuers

88. "Briefly, the argument overlooks the fact that the legislation which Congress was considering involved, among other things, detailed and complex regulation of pension funds through the prescription of duties and responsibilities in the day-to-day operation of pension funds, requirements for the filing of disclosure documents with a government agency, and the delegation to the agency of authority to adopt detailed rules and regulations with respect to pension funds.

The Commission's position that it was not the appropriate agency to administer such a statute is entirely consistent with its long-standing refusal to require, in the case of pension fund interests, compliance with the registration provisions.

That does not mean, however, that these securities are not covered by the antifraud provisions. The commission's reluctance to administer provisions of a regulatory nature, or provisions requiring detailed affirmative disclosure, in no way affects the separate question of the applicability of the far different antifraud provisions." Letter of SEC Chairman Williams, dated February 8, 1978, to Senator Harrison Williams, BNA Daily Rep. for Exec. No. 29, p. J-1-J-2 (February 10, 1978).

in that industry by another statute (viz., the federal securities laws) is *not unusual in our federal scheme*. The question of overlapping jurisdiction of employee pension plans was specifically recognized by Congress and dealt with in the Investment Company Amendments Act of 1970.

The 1933 and 1934 Acts are part and parcel of a comprehensive set of federal securities laws. They are designed in part to protect the buyer of securities from fraud. Neither by its terms nor by implication does ERISA in any way indicate a Congressional intent to supersede the antifraud provisions of these federal securities laws. Rather, because both the federal labor and securities laws serve to protect the employee-investor in a pension plan—albeit in different ways—they must be viewed as complementary to one another. This is made abundantly clear from the fact that even petitioners concede that certain employee pension plans are subject both to ERISA and to the federal securities laws. See p. 71 and n. 59, *infra; SEC* v. *Garfinkle*, CCH Fed. Sec. L. Rep. Para. 95,020 (S. D. N. Y. 1975). There is no incompatibility between ERISA and the federal securities laws. Repeal of the securities laws is not "necessary to make [ERISA] . . . work . . ." *Silver* v. *New York Stock Exchange*, 373 U. S. 311, 357-58 (1963); *Gordon* v. *New York Stock Exchange*, 422 U. S. 659, 682-83 (1975); *cf. Ricci* v. *Chicago Mercantile Exchange*, 409 U. S. 289, 301 (1973); *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F. 2d 264, 268 (7th Cir. 1970). The effective application of both the federal securities laws and ERISA to employee pension plans will in no way impede or interfere with either statutory scheme. They work together.

C. Disclosure Under the Federal Securities Laws and ERISA.

The registration requirements under the 1933 Act—commonly referred to as the "disclosure" provisions—are designed to assure that investors are given that information needed to make a reasoned investment decision prior to or at the time such a decision is taken. The mechanism of meeting this objec-

tive is the filing with the SEC of a registration statement, and the delivery to the investor of a detailed prospectus. By contrast, the antifraud rules require the filing of no such documents. Rather, the antifraud provisions require that whatever representations are made to induce a purchaser to invest be complete and truthful. Consequently, if a seller makes a representation rendered intentionally misleading by the failure to disclose other material facts, he is under an obligation to make such further disclosures. In the context of an *intentionally* misleading statement to an employee contemplating an investment in an employee pension plan, the employee-investor needs to be told the true facts relative to the value of his investment—including the risk of loss—at a time when such information has meaning, at a time when the employee can still decide not to make, or not to continue making, the investment. In contrast, the disclosure required by ERISA generally need only be made 90 days (or more) *after* an employee becomes an investor in an employee pension plan. ERISA Sections 104(b)(1)(A) and (B).

Even more important than the differences in timing of disclosure are the differences in the content of disclosure. When defendants communicate the details of an employee pension plan to an employee and seek to induce his investment and participation on the basis of misrepresentations and omissions, all facts which a reasonable investor would consider important in the making of an investment decision must be disclosed under the antifraud rules of the federal securities laws. *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U. S. 438, 450 (1976). The most important fact that an employee investing in a pension fund would want to know is that the investment carries with it a risk of loss, as well as the possibility of profit. In the context of the instant case the employee would also want to know the nature of the risk, its extent, and the factors contributing to the risk.

In contrast, there is no requirement under ERISA that an employee-investor in the Local 705 Pension Fund be told that there is a risk of loss or the nature and extent of this risk. All that ERISA requires is that the employee be told the substantive plan provisions. For example, an employee-investor being offered an investment in a pension plan which will pay monthly retirement benefits for each year of service need not be told that there is a risk he may not participate in the plan for the period necessary to acquire a "vested" right. Similarly, he need not be told the extent of that risk, *e.g.*, that the plan's actuary has assumed or that the plan's experience studies show that three-quarters, or two-thirds, or some other percentage of the employees covered by the plan will terminate employment before vesting or die before retirement age. Further circumscribing the nature of ERISA disclosure are those disclaimers of liability for statements contained in most post-ERISA summary plan description booklets.[89]

The reasons for the differences in the timing and content of disclosure under ERISA and under the federal securities laws relate to the different purposes each statute is meant to serve. The federal securities laws are designed to provide investors with the full and accurate information they need to make

89. Employee-investors are told by such disclaimers that they can rely on such booklets only at their peril and that, in the event of a conflict between the booklet's description of the plan provisions and the technical language of the plan document on file at the main office of the plan, the provisions of the plan document are to control. The effect of such disclaimers is to discourage the careful reading of such descriptive booklets. They thus effectively undercut the disclosure function of the booklet. The Department of Labor has not acted to ban such disclaimers. Letter dated Nov. 28, 1977, from Ian Lanoff, Administrator, Pension and Welfare Benefit Program, U. S. Dept. of Labor, to Victor Kramer, Director of the Inst. for Public Int. Rep., published in B. N. A. *Pension Rep.* No. 167 p. R-4 (Dec. 12, 1977). In contrast, Section 14 of the 1933 Act and Section 29 of the 1934 Act specifically make waivers of liability ineffective. See *Wilko* v. *Swan,* 346 U. S. 427 (1953).

reasoned and informed investment decisions. In contrast, ERISA disclosure is primarily addressed to employees who are already investors in an employee pension plan. The purpose of this disclosure is not to allow the investor to make a reasoned investment decision, but to protect the employee-investor from losing his pension benefits inadvertently, through ignorance of the plan provisions. ERISA disclosure is based on the premise that it is "grossly unfair to hold an employee accountable for acts which disqualify him from benefits, if he had no knowledge of these acts, or if these conditions were stated in a misleading or incomprehensible manner in plan booklets." S. Rep. No. 127, 93rd Cong., 2d Sess. in 3 *U. S. Code Cong. and Admin. News.* at 4847 (1974).

Because of the differences in content, timing, and the purposes of ERISA and securities law disclosure, ERISA can only be said to complement, and not to replace, the antifraud provisions of the federal securities laws. Were this not the case, an intentional securities fraud could be perpetrated against an investor in an employee pension plan outside the scope of ERISA and without a remedy to such investor. This surely Congress did not intend.

III.

PETITIONERS' ARGUMENTS OF PROSPECTIVE FINANCIAL RUIN AND DISTORTION OF THE COLLECTIVE BARGAINING SYSTEM DO NOT INSULATE PETITIONERS FROM LIABILITY UNDER THE ANTIFRAUD RULES.

Because petitioners cannot overcome the decision below by analysis of the federal securities laws, their main arguments are directed to a doomsday prophecy. However, with almost uncanny precognition, Mr. Justice Harlan disposed of the doomsday argument 74 years ago. Although the Court in *Northern Securities Co.* was speaking of the application of the anti-trust laws, its rejection of the doomsday argument is no less applicable to the effort by Congress to curb abuses in the securities field. Petitioners have thus learned nothing from history. In defense

of an egregious securities fraud which has robbed the Teamster rank and file of their retirement savings, defendants offer up what the Court of Appeals has termed a *concursus horribilum*. Pet. App. p. 258a. The same "suggestions of disaster" which the Supreme Court rejected 74 years ago must also be rejected today.[90]

A. Application of the Antifraud Rules to a Securities Fraud Case Will Not Distort the National Collective Bargaining System.

Without support in either law or fact, the major argument of petitioners consists of the misapprehension that application of the antifraud rules of the securities laws to defendants' fraud will somehow undermine the entire collective bargaining system in the country. Such "predictions of ruin" cannot withstand analysis. Viewed in the harsh light of day, this argument is nothing more than a lame plea that the defendants should be permitted to defraud the Teamster rank and file.

Such arguments are, in fact, not novel. They seem to be marshalled whenever an attempt is made to remedy the wide-

90. "Many suggestions were made in argument based upon the thought that the anti-trust act would in the end, prove to be mischievous in its consequences. Disaster to business and widespread financial ruin, it has been intimated, will follow the execution of its provisions. Such predictions were made in all the cases heretofore arising under that Act. But they have not been verified. It is the history of monopolies in this country and in England that predictions of ruin are habitually made by them when it is attempted, by legislation, to restrain their operations and to protect the public against their exactions. In this, as in former cases, they seek shelter behind the reserved rights of the states . . .

The suggestions of disaster to business have, we apprehend, their origin in the zeal of parties who are opposed to the policy underlying the act of Congress or are interested in the result of this particular case; at any rate, the suggestions imply that the Court may and ought to refuse the enforcement of the provisions of the act if, in its judgment, Congress was not wise in prescribing as a rule by which the conduct of interstate . . . commerce is to be governed, that every combination, whatever its form, in restraint of such commerce . . . shall be illegal. These, plainly, are questions as to the policy of legislation which belong to another department . . ." *Northern Securities Co.* v. *United States*, 193 U. S. 197, 351-52 (1904).

spread abuses found prevalent in employee pension plans. For example, the Court in *Malone* v. *White Motor Corp.*, ... U. S. ...., 98 S. Ct. 1185, 1192 and n. 9 (1978), noted that similar arguments were made in the discussions preceding enactment of the Welfare and Pension Plans Disclosure Act of 1958:

> "Indeed, the bill met opposition in both the Senate and the House on the ground that its approach would 'require employers to surrender to labor unions economic and bargaining power which should be negotiated through the normal channels of collective bargaining.' S. Rep. No. 1463, [85th Cong., 2d Sess.] . . . at 34 (Minority View of Sen. Abbott); accord H. R. Rep. No. 2283 [85th Cong., 2d Sess.] . . . at 25 (Minority Views). . . . [and] opponents of the bill argued that the legislation would 'seriously interfer with . . . bargaining relationships by given labor access to information about the costs of certain employer-administered benefit plans. 104 Cong. Rec., at 7209 (remarks of Sen. Abbott)." *Id.*

These arguments were not persuasive in forestalling the enactment of the WPPDA—which had a far more pervasive impact on employee pension plans than any application of the antifraud rules of the federal securities laws will ever have. And, these arguments are not persuasive here.

1. The Antifraud Rules Will Not Jeopardize Union Status or Labor Peace.

Section 9 of the National Labor Relations Act, 29 U. S. C. Section 159, provides that the union as the collective bargaining representation will be the exclusive representative of the employees in negotiations with employers concerning wages, hours, and other conditions of employment. Affirmation of the decision below will in no way denigrate the exclusive representative status of the collective bargaining representative. Petitioners assert that as a result of the application of the antifraud rules of the securities laws—the plaintiff, and other Teamster union members, will have the right to bargain *individually* with their employers in violation of Section 9 of the

NLRA. Although petitioners do not clearly identify the source of this alleged "right to bargain individually," it must arise, if at all, from the fact that plaintiff and other Local 705 members vote to ratify Local 705 labor contracts with covered employers.

This right to vote, however, does not give plaintiff the right to bargain individually. First, this right to vote *antedates* this lawsuit. The right of Local 705 members to vote in ratification on any Local 705 negotiated collective bargaining agreement is called for in the Local 705 *constitution*. The application of the antifraud rules of the securities laws to defendants' fraud has *nothing whatsoever* to do with granting plantiff an individual right to vote. Plaintiff had no right to bargain individually with employers prior to the bringing of this lawsuit, and has no right now.

Petitioners' argument are thus misdirected and unpersuasive. Application of the antifraud provisions of the federal securities laws to the fraudulent sale here of a security in the Local 705 Pension Fund will not interfere with the national commitment to collective bargaining. The plaintiff is not suggesting that either he or any other individual union member be chosen to supplant Local 705 as the exclusive representative in collective bargaining negotiations with employers. This conclusion is not altered by the fact that, by virtue of the Local 705 and IBT constitution, all Local 705 members do have the right to vote on the labor contract. And, that contract does allocate employee compensation between cash wages, investments in the Local 705 Pension Fund, and other economic benefits. In like fashion, a corporate merger may be negotiated by corporate management, approved by the board of directors, and then put out to the shareholders for their vote. In neither case do the corporate shareholders or the Local 705 union members supplant the right of corporate management and directors or the right of the Local 705 union officers, respectively, to negotiate the terms of sale of the securities involved, even though that be but one aspect of the corporate merger or labor contract.

Petitioners also pose the threat of untimely delays, widespread strikes, and the loss of labor peace throughout the country. These speculative horribles have an existence only in the eyes of petitioners and not in reality. Because it does not exist, petitioners cannot provide the connection between application of the antifraud rules in this case and such horribles as they prophesize. The fact that many employee pension plans are *concededly subject* to the federal securities laws, including the registration requirements, without endangering the entire collective bargaining system in the country, exposes the emptiness of defendants' argument. By providing in their union constitution for a ratification vote, petitioners certainly seek not a "rubber stamp" but bona fide guidance on the substantive terms of the proposed labor agreement.

2. The Decision Below Does Not Require Registration with the SEC.

Petitioners also raise the speculative horrible of a vast new bureaucracy, laying its heavy hands on the American pension system. Here again, the horrible is more phantom than substance, for petitioners in their "quintessential error" again confuse the registration requirements with the antifraud rules of the federal securities laws. Application of the antifraud rules to defendants' securities fraud does not require registration under the 1933 Act. It does not require the filing of any reports, registration statements, or documents with the SEC. It only requires defendants not fraudulently to induce employee-investors to invest into the Local 705 Pension Fund.

The decision below is expressly limited to the antifraud provisions of the securities laws:

> "We wish to emphasize that we are not holding the registration requirements of the 1933 Act or the reporting requirements of the 1934 Act to be applicable to these pension funds. We do not require the filing of any document or establish judicial control over pension fund operations." Pet. App. 258a.

In fact most employee pension plans will be exempted from the registration requirements of the 1933 Act by Section 3(a)(2).[91] And, those not exempted by Section 3(a)(2) "might be deemed beyond the scope of the registration requirements . . . because of . . . long time and consistent [SEC] administrative practice." Pet. App. p. 258a n. 61. As noted throughout this Brief, this policy is to require registration *only* for those employee pension plans in which an amount in excess of the employer's contributions are invested in employer securities.[92] See p. 71 and n. 59, *supra*. And, the present Chairman of the SEC, Harold M. Williams, has recently reiterated this policy.[93] Finally, as noted above (pp. 94-95), what is considered a "sale" for purposes of the antifraud rules is not necessarily a "sale" for purposes of the registration requirements. See, *e.g.*, *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969).

91. The Court of Appeals has estimated that up to 96 percent of all pension plans may be exempted from registration by Section 3(a)(2) of the 1933 Act. Pet. App. p. 258a n. 61. This has been challenged by the IBT, IBT Br. at 25, although without citation or support. However, even accepting, *arguendo*, the IBT figure ($50 billion), pension funds with assets in excess of *two-thirds* of the total assets of all private noninsured pension funds (approximately $180 billion) in the country will be so exempt. See n. 25, *supra*.

92. See n. 59, *supra*. Although a "longtime and consistent" administrative policy of the SEC, Pet. App. p. 258a n. 61, the SEC also has the clear authority to promulgate a rule exempting from registration all such employee pension plans. Pursuant to its authority under Section 19(a) of the 1933 Act to define "accounting, technical, and trade terms," the SEC has in the past defined the term "sale" as excluding a particular type of transaction from the registration requirements, but not from the antifraud rules. See, e.g., SEC Rule 133, 17 C. F. R. § 230.133 (1964). A similar rule could be promulgated by the SEC to reflect its long held position that a distribution of interests in compulsory, noncontributory pension plans to employees does not constitute a "sale" for purposes of the registration requirements. See *1941 Opinion*.

93. "In sum, the situation today at the Commission with respect to the registration of pension interests is fundamentally the same as it has been since the Commission's creation." *Williams Testimony*, *supra* n. 60, at 5-6.

Petitioners are, therefore, misguided when they assert that compliance with *Daniel* will be unduly burdensome. First, the antifraud rules of the federal securities laws differ from the registration requirements in that they "do not establish an affirmative disclosure system requiring the filing of documents. Rather, [they] . . . are essentially a generalized self-executing prohibition against fraudulent activity." Pet. App. p. 252a. All that they require is that whatever disclosure is made not be intentionally "deceptive or misleading." *Williams Jan. 5 Letter*, p. 44, *supra*, at F-1.

> "The antifraud provisions . . . are a generalized prohibition upon fraudulent conduct, including the making of false or misleading representations. If a person chooses to make a representation which is rendered misleading by the failure to disclose other facts, he is obligated to make further disclosures. But, the antifraud provisions do not constitute a general requirement of detailed affirmative disclosure, either oral or written."

Letter from SEC Chairman Harold M. Williams to Senator Harrison A. Williams, Jr., dated Dec. 7, 1977, BNA Sec. Reg. & L. Rep. No. 433, p. I-2 (Dec. 21, 1978). Compliance with this requirement will "not impose an undue burden on anyone." *Mundheim and Henderson* at 814; *Williams Jan. 5 Letter* ("no adverse consequences . . . in terms of cost").

In this regard, Chairman Williams has noted:

> "A document which makes satisfactory disclosure under ERISA, in compliance with ERISA's requirements as to the contents of disclosure documents, would not, except in highly unusual circumstances, be violative of the antifraud provisions of the federal securities law . . . [and] the significant role to be served in the pension area by the antifraud provisions of the federal securities laws is that of providing protection where false or misleading representations are made either orally or in written materials other than the documents required by ERISA." *Id.*

Furthermore, petitioners misread the decision below if they infer from it that the Court of Appeals would require disclosure of the actuarial probability of ever receiving a pension benefit or disclosure of any other *particular* fact. Of course, the only issue before the court below was whether the antifraud rules of the federal securities laws were applicable, and not what disclosures were required. In addition, the remarks of the Court of Appeals as to what should have been disclosed were made within the context of the deceptive and misleading statements made by the Teamster defendants in the instant case. In any event, as indicated by one group of actuaries, there should be no problem in coming up with a percentage indicating the likelihood that the participants as a *group* will receive a pension.[94] B. N. A. Pension Rep. No. 173, p. A-18 (Jan. 30, 1978).

Compliance with the antifraud rules of the federal securities laws thus should be no more difficult for an honest employee pension plan than for any other issuer—including those, like a mutual fund, which periodically issue securities. Petitioners therefore cannot support their proposition that application of

94. Petitioners and their *amicae* harp on the invalidity of developing the probability that any *particular individual* will ever receive a pension. In so doing, petitioners expose their misunderstanding of the antifraud rules of the federal securities laws. First, as noted above, no particular fact is required to be disclosed under the antifraud rules—all that is required is that whatever disclosure is made not be intentionally misleading or deceptive. Second, in the context of certain possibly misleading or deceptive representations, a statement of the *group likelihood* of ever receiving a pension might well go to correct any such possible misrepresentations. Such a group likelihood could, for example, either be a statement of the *actuarial assumptions* used by a pension plan's actuaries in constructing the pension plan, or a statement of *actual group experience* in receiving pension benefits under such plan. Such actuarial assumptions are, of course, easily available to the plan's administrators, and, as the *Grubbs Study, infra,* indicates (at p. IV-6), actuaries do make experience studies to determine actual rates of termination of employment and other factors. Furthermore, in many if not most cases of possible misrepresentation, all that is called for is disclosure of the material fact of the *existence* of the possibility of a risk of loss of a participant's investment in a pension plan due to a variety of factors. Cf. *TSC Ind., Inc.* v. *Northway,* 426 U. S. 438, 450 (1976).

the antifraud rules of the federal securities laws to employee pension funds will deter the formation of employee pension plans. Surely, all honest employee pension plans and their sponsors would applaud the application of the antifraud rules to their industry.

Finally, perhaps the most telling point is the fact that certain employee pension plans are conceded by petitioners to be subject both to ERISA and the federal securities laws. Petitioners acknowledge that certain so-called "voluntary and contributory" pension plans are subject to the antifraud rules as well as to the registration requirements of the 1933 and 1934 Acts. Notwithstanding petitioners' fears, the application of the federal securities laws to these plans has not wreaked havoc on such plans. Indeed, the continuing creation of such plans, even though they must register under the 1933 Act, indicates well the lack of any detrimental burden. Petitioners thus are unable to demonstrate that the application of the federal securities laws have in any way disrupted these plans.

In fact, the securities laws and ERISA have become increasingly complementary as the SEC continues its efforts to revise Form S-8 to avoid duplication of, *but not defer to,* the ERISA requirements. Sec. Act Rel. No. 5767 (Nov. 22, 1976), CCH Fed. Sec. L. Rep. ¶ 80,809 at 87,110-11; *SEC* v. *Garfinkle,* CCH Fed. Sec. L. Rep. Para. 95,020 (S. D. N. Y. 1975). As SEC Commissioner Williams has recently indicated, these efforts are quite extensive.[95]

95. "The Subcommittee's final question sought the Commission's policy views on the possible overlap between ERISA and other federal laws, including the securities laws. The Commission does not, of course, endorse duplicative government regulation. . . . Since ERISA's adoption, the Commission has endeavored to coordinate the requirements of ERISA with its own regulations. The Commission formed a special task force to study and deal with any problems of over-regulation or conflicting regulation that could arise, and that special task force had a significant impact on coordinating the requirements of ERISA with the legitimate needs of the brokerage community. Thus, the Commission commented upon, and helped develop, regulations issued by the Department of Labor and the

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B. Petitioners' Doomsday Prophecy Is No Shield from Liability for Securities Fraud.

Petitioners' most incredible argument is the doomsday prophecy that application of the securities antifraud rules will result in "vast liabilities". The size of this king's ransom has been estimated by amicus below to be 200 billion dollars ($200,000,000,000). ERIC Court of Appeals Br. p. 29. As might be expected with such an incredible figure, petitioners' apprehension of disaster rests on a misconception of this case and of the federal securities laws.

1. The Issue of Damages Is Not Now Before This Court.

Petitioners are rather presumptuous to set out at this stage of the litigation their own preferred remedy for their securities fraud, and then to work out in some magical fashion the arithmetic consequences. Indeed, the issue of what is an appropriate remedy for defendants' fraud is not before this Court. Rather, what is before this Court on appeal is solely whether the antifraud rules of the federal securities laws are applicable to defendants' fraudulent sale to plaintiff of a security in the Local 705 Pension Fund. The question of damages is for the District Court to decide. This is particularly so here where the

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Internal Revenue Service dealing with several issues arising under ERISA and affecting the securities industry . . . The Commission has also acted to help ease the reporting requirements of the securities laws for those entities which are also subject to ERISA. A major step in this effort was a revision of Form S-8, the registration form used by issuers selling securities to their employees pursuant to certain employee benefit plans. Since many of these plans must now also file disclosure statements under ERISA, the Commission worked with the Department of Labor to develop a form that would reduce the possibility of duplicative regulation. The form now provides that, to reduce the burdens imposed by Form S-8, issuers may utilize the summary plan descriptions prepared for ERISA, by including a copy of the summary plan descriptions as part of the S-8 prospectus in lieu of all or part of certain items of information required by the form. This is a good example, in my opinion, of the Commission's efforts to adapt its regulatory requirements to the new environment created by ERISA. . . ." *Williams Testimony, supra* n. 60, at 9-11.

present appeal is on an interlocutory order denying defendants' motions to dismiss. This Court in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375, 386 (1970), has thus stated quite clearly that a finding of liability is unrelated to a determination of the appropriate remedy:

> "Our conclusion that petitioners have established their case by showing that proxies necessary to approval of the merger were obtained by means of a materially misleading solicitation *implies nothing about the form of relief to which they may be entitled.* We held in *Borak* that upon finding a violation the courts were 'to be alert to provide such remedies as are necessary to make effective the congressional purpose,' noting specifically that such remedies are not to be limited to prospective relief." (Emphasis added).

See *J. I. Case* v. *Borak*, 377 U. S. 426, 433 (1964). Also directly in point is *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 288, 241 (2d Cir. 1974), where the Second Circuit stated:

> "Finally, having held that all defendants violated Section 10(b) and Rule 10b-5 and that they are liable to plaintiffs in this private action for damages, we leave to the district court the appropriate form of relief to be granted, including the proper measure of damages. This comports with the procedure followed in other cases where appellate courts have determined issues of liability for violations of the securities laws. . . . In the instant case there are *especially compelling reasons for following this procedure. Since the appeal comes to us from an interlocutory order denying defendants' motion for judgment on the pleadings, there was no issue before the district court and of course no adjudication below on the form of relief to be granted.*" (Emphasis added).

Thus, it is for the District Court, at first instance, to fashion a remedy so as to grant the necessary relief where federally secured rights are invaded.

2. Petitioners' Financial Doomsday Argument Is Wrong.

Petitioners' financial doomsday argument is not only improper, it is also just plain wrong. The initial 200 billion dollar liability prophesized is absurd. Recognizing this, petitioners now have lowered their sights by at least one order of magnitude to between $3.5 to $13.5 billion dollars. Local 705 Br. at 36; Grubbs, Report to the Secretary of Labor-Potential Effects of *Daniel* at p. III-2 (March 20, 1978) (the "*Grubbs Study*"). Even these figures, however, are incredible. They ignore reality and rest on a misconception of the federal securities laws.[96] Petitioners thus should not be allowed to camouflage their securities fraud.

Petitioners, first, ignore the fact that, the extent of any liability for pension fund securities fraud is limited by, among other factors, the applicable statute of limitations, the requirement of scienter, and remedy considerations. The decision below is restricted to the particular facts of a Teamster union multi-employer pension fund. It is not necessarily applicable to a non-union corporate employee pension fund which may have characteristics unlike those of the Teamsters pension fund here involved.[97] These limitations have, moreover, been *expressly* recognized by the Court of Appeals:

96. For example, petitioners fail to note that the *Grubbs Study* is based on *a sample of only seven pension plans*, only two of which were multiemployer plans covering union employees. *Id.* at p. A-7-A-9. Furthermore, the measure of damages projected in the *Grubbs Study* proceeds on the outrageous assumption that all interests in all employee pension plans in the country have been sold by means of an intentional securities fraud, and is itself based on outdated information more than ten years old. *Id.* at p. B-3. In addition, Petitioner Local 705's attempt to rely on the A. S. Hansen actuarial study is improper as well as faulty. First, with this study appended to its brief, *Local 705 has improperly sought to augment the record on certiorari review by this Court.* Second, the A. S. Hansen study itself blithely ignores the complex body of law underlying the question of the proper measure of damages in a securities fraud case. It also conveniently ignores the extent of liability of the other—non Local 705 Pension Fund—defendants in this case.

97. The decision below that Daniel's investment in the Local 705 Pension Fund represents the purchase of a security for the purposes

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"Moreover, plan liability, given the fact that employees' interests in pension funds are covered by the anti-fraud provisions of the securities acts, is still limited by a number of factors. Particular employees must show, in light of all the ambient circumstances, justifiable reliance on a material misrepresentation or omission causing them injury. If all material facts are disclosed in a manner comprehensible to the average workers, as in any other securities fraud case, no damage causation will exist under the securities laws. . . . Thus if the plan documents sent to a plan beneficiary understandably disclose this information, a retiree who does not meet the vesting requirements will have no remedy under the securities acts, even if he subjectively did not comprehend the disclosed information. In addition, other pension funds may be immunized by the applicable statute of limitations. These considerations, as well as others, may arise here and in future cases as constraints on plan liability." Pet. App. p. 259a.

Of most importance, however, is the fact that liability is limited to those pension fund securities sold by means of a fraud.[98] As noted above, the securities fraud here is particularly egregious because of its continuing nature, the unique risk of

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of the antifraud rules is limited to the particular facts of a Teamster union negotiated multi-employer pension fund. Consequently, the holding below is not necessarily applicable to a non-union corporate employee pension fund which may have characteristics unlike those of the Teamster pension fund here involved. In addition, other union negotiated multi-employer pension funds may not be subject to ratification by member vote, and for that reason may fall outside the present analysis. However, for the reasons discussed above, plaintiff does not believe there to be a "volitional" requirement to the definition of "sale," and, in any event volition is present in an employee's decision to work or to continue working for his employer, in addition to the volitional dimension of the employee's ratification vote. Finally, and for these reasons, this case has *no applicability* to any employee benefit plans other than the type of employee *pension* or *retirement* fund Daniel has invested in. See, e.g., *Robinson* v. *United Mineworkers of America*, 435 F. Supp. 245, 246 n. 1 (D. D. C. 1977) (U. M. W. *Health* Fund).

98. For example, after holding that an interest in an employee pension plan is a "security" acquired by way of a "sale," the court in *Schlansky, supra* n. 49, dismissed plaintiff's complaint—with leave to replead—for failing properly to plead defendants' scienter.

wholesale loss in a Teamster pension fund, and the Draconian nature of the vesting requirements. The Teamster pension funds stand out because of the *scienter* underlying the fraudulent inducement to the rank and file to invest on the promise of profits in the form of retirement benefits. *Ernst and Ernst* v. *Hochfelder, supra.*

Plaintiff is not alleging any securities fraud in the sale of any other pension fund security outside of the Teamsters union. Furthermore, petitioners' implied assertions that all, or even most, other pension funds are sold by means of an *intentional* securities fraud simply have no basis in fact. Accordingly, in response to a question about the extent of possible retroactive liability following *Daniel,* SEC Chairman Williams stated:

> "I appreciate your concern about the threat of lawsuits asserting liability for past events, but *honest plan sponsors, who have operated pension plans honestly need not fear retroactive liability* under the antifraud provisions of the federal laws." *Williams Jan. 5 Letter at F-2.*

Finally, even the *Gubbs Study* cited by petitioners recognizes this:

> "Most terminated non-vested participants have *not* been led to expect that they were entitled to a pension. If liability exists only with respect to terminated participants who received information leading them to expect a pension, *it does not apply to most terminated participants. In such a case the potential liability would be a very small fraction of the amounts shown. . .*" *Id.* at p. II-3.

Equally wrong, if not irrelevant, is petitioners' implication that a proper remedy here to petitioners' own securities fraud would endanger the pensions due presently vested Local 705 members. This argument is wrong because vested union members should not benefit from fraud perpetrated against fellow employees. Indeed, this argument is also offensive because it ignores the fact that there are defendants other than the Local 705 Pension Fund in this case who have participated in this intentional securities fraud. Surely, the defendant unions and the

individual defendants (sued also in their individual capacities) must share the burden of any damages assessed by the District Court. Finally, this argument is irrelevant because this case involves "no issue of priority of claims" against the Local 705 Pension Fund. Indeed, this Court has rejected just such an argument:

> "The respondents have argued that we should not declare the petitioners' withdrawable capital shares securities under § 3(a)(10) because the petitioners, if they are successful in their suit for rescission, will gain an unfair advantage over other investors in City Savings in the distribution of the limited assets of that Association, which is now in liquidation. *This argument, at best, is a non sequitur. This case in its present posture involves no issue of priority of claims against City Savings.* This case involves only the threshold question of whether a federal court has jurisdiction over the complaint filed by the petitioners—a question which turns on our construction of the term 'security' as defined by § 3(a)(10) of the Securities Exchange Act of 1934. It is totally irrelevant to that narrow question of statutory construction that these petitioners, if they are successful in their federal suit, might have rights in the limited assets of City Savings superior to those of other investors in that Association." (Emphasis added).

Tcherepnin v. *Knight,* 289 U. S. 332, 346 (1967).

Petitioners also derive no support from their extensive reliance on *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U. S. 723 (1975).[99] Indeed, Respondent rejects petitioners' allegations and

99. In *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U. S. 723 (1975), an offeree declined to purchase certain securities because of the defendant-offeror's alleged misleading statements. There, the Court decided against expanding the scope of persons protected by Rule 10b-5 to frustrated buyers and, therefore, beyond the scope of the purchaser-seller requirement of *Birnbaum* v. *Newport Steel Corp.,* 193 F. 2d 461 (2d Cir. 1952). *Blue Chip Stamps* thus provides no support for defendants here because the plaintiff, John Daniel, as a purchaser of securities, clearly falls within the *Birnbaum* rule. The decision below does not expand the class of persons protected by the antifraud rules of the federal securities laws beyond that allowed by *Blue Chip Stamps* and *Birnbaum.*

asserts that the instant lawsuit can in no way be construed as "vexatious" or as a "strike suit".[100] The fraud of petitioners here is particularly egregious because of its continuing nature: even now, over four years from the filing of the Complaint, petitioners have failed to disclose the material facts attendant to an investment in the Local 705 Pension Fund. Petitioners thus cannot be allowed to turn their continuing fraud into a shield from liability under the federal securities laws.

The concern of *Blue Chip Stamps* over the problems of proof which would result from the abandonment of the *Birnbaum* rule also provides no support for petitioners because the *Birnbaum* rule was not breached by the decision below and because proof of the fraud here may be established by independent documentary evidence. The problems of proof of concern to this Court in *Blue Chip Stamps* relate to the burden of showing that an offeree did not rely on a misleading statement in deciding *not* to purchase a security. *Blue Chip Stamps,* 421 U. S. at 745-47. Because a security was *not* purchased, if *Birnbaum* were not followed, a whole universe of potential investors would have standing and of necessity only oral testimony could be relied on:

> "Plaintiff's proof would not be that he purchased or sold stock, a fact which would be capable of documentary verification in most situations, but instead that he decided *not* to purchase or sell stock." *Id.* at 746.

Here, Daniel's purchase of an interest in the Local 705 Pension Fund is subject to independent documentary verification.

Finally, petitioner IBT seeks the last safe harbor from its intentional securities fraud in a plea for the prospective application of the ruling below.[101] IBT Br. at 135-140. In doing so,

100. Even the petitioners "acknowledge the equities" of plaintiff's case here. Counsel for petitioner IBT on oral argument below, Transcript p. 42.

101. There is, interestingly, another side to this coin. The adoption, *arguendo,* of petitioners' ERISA pre-emption argument would provide a shield from liability for pension fund securities fraud *subse-*

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petitioner relies heavily on *Los Angeles Dept. of Water and Power* v. *Manhart, supra,* rather than establishing the *Chevron Oil Co.* v. *Huson,* 404 U. S. 97, 106-107 (1971), criteria for limiting a ruling to a prospective application only. There is, in fact, a serious question whether the first Chevron factor—"a new principle of law . . . by deciding an issue of first impression whose resolution was not clearly foreshadowed"—can be met here. Certainly, if anything the legislative history set out above establishes that, if not an *old* principle of law, the holding below was "clearly foreshadowed."

In any event, assuming, *arguendo,* that all three *Chevron* criteria are met and that a prospective application of *Daniel* precludes retroactive liability elsewhere, petitioners still are not out of the storm. The intentional securities fraud perpetrated on the plaintiff would, in such event, mandate the application by this Court of the (then) prospective *Daniel* rule to this case and to its consolidated companion case.[102] Not to do otherwise would be to reward the defendants for their fraud, and to punish the defrauded plaintiff for his efforts. Cf. *Molitor* v. *Kaneland Community Unit District No. 302,* 163 N. E. 2d 89, 97-98 (Ill.), cert. den. 362 U. S. 968 (1960). It would, further, produce the type of "inequitable result" which constitutes the third *Chevron* factor.

The petitioners here, therefore, do not stand on the same ground as the Water Department in *Manhart.* Not only is a completely different statute involved—the federal securities laws as distinguished from Title VII of the 1964 Civil Rights

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quent to the enactment of ERISA. In this way, the extent of any liability for pension fund securities fraud would be *limited*—although petitioners would remain liable here because this lawsuit involves a pre-ERISA securities fraud.

102. See *Dutchak* v. *International Brotherhood of Teamsters, supra* n. 29, consolidated with the instant case by the District Court below. The defendants in *Dutchak* include (among others) the infamous Teamsters Central States, Southeast and Southwest Areas Pension Fund and the Local 710 Pension Fund, as well as the Local 705 Pension Fund and the IBT.

Act—but also the Water Department in *Manhart* was not reaping the fruits of its intentional fraud.[103] The same reasoning distinguishes the petitioners here from the employer in *Allied Structural Steel Co.* v. *Spannaus,* 46 U. S. L. W. 4887 (June 28, 1978).

Recognizing interests in employee pension plans to be securities, Congress in the 1970 Act expressly exempted most of such plans from the registration requirements, but not from the antifraud rules. In 1974, Congress expressly saved such legislation from pre-emption by ERISA. Any need the petitioners feel for further legislation in this area should be directed to Congress. And, indeed, at least one bill introduced in the Senate last session deals with these issues. See ERISA Improvements Act of 1978, S. 3017 (introduced May 1, 1978, by Senators Harrison Williams and Jacob Javits).[104] Finally, this has been specifically recognized by SEC Chairman Williams:

> "The Commission is, of course, aware that there is some sentiment for a legislative response to the issues which the *Daniel* case raises. Whether there is a need for further legislation addressing the protections against fraud to which those acquiring interests in pension funds are entitled is, of course, a question which Congress, and not the Commission, is best able to resolve. Our concern is, as the *Daniel* case illustrates, with protecting investors within the framework of the existing securities laws. At present, while other important federal legislation governs various aspects of pension plans, *the federal securities laws offer an important protection against fraud in connection with the acquisition of pension interests which is unavailable outside of those laws.*" *Williams Testimony, supra* n. 60, at 13.

103. The sponsors of the Teamster pension funds are a far cry from the "conscientious and intelligent administrators of pension funds" present in the *Manhart* case. *Manhart, supra,* at p. 4352.

104. If enacted, this bill would, among other things, exclude interests in compulsory, noncontributory employee pension plans from the definition of "security" under the federal securities laws.

CONCLUSION.

For all of the reasons set forth above, we submit that the unanimous decision of the Court of Appeals was correct, consistent with the statutory language and applicable case law, and should be affirmed.

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